Jean F. Carroll
8-25-28

HARVARD BUSINESS REPORTS

COMPILED BY AND PUBLISHED FOR THE
GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
GEORGE F. BAKER FOUNDATION
HARVARD UNIVERSITY

VOLUME 3

[Cite cases in this Volume as 3 H. B. R.____]

CHICAGO & NEW YORK
A. W. SHAW COMPANY
LONDON, A. W. SHAW AND COMPANY, LIMITED
1927

COMMENTARIES IN THIS VOLUME

BY

MELVIN THOMAS COPELAND
Professor of Marketing

COMMENTATOR'S FOREWORD

This volume has been prepared in pursuance of the general purpose of the Harvard Graduate School of Business Administration to publish in the *Harvard Business Reports* the cases which it has collected. All the cases in this volume have to do primarily with marketing problems. This group includes some cases which have been published in my book, *Problems in Marketing,* and others published in Bulletin No. 55 of the Harvard Bureau of Business Research, *Cases on Merchandise Control in the Wholesale Grocery Business,* but a majority of the cases are published here for the first time.

A part of the cases in this volume were gathered in 1922 in the course of the collection of the material for *Problems in Marketing* but not selected for use in that book. Others have resulted from several special studies conducted by the Harvard Bureau of Business Research. Still others were obtained incidentally by agents of the Bureau while gathering cases on other subjects. Some of the cases are incomplete and fragmentary. They are published, however, in the expectation that they may have at least some historical value in recording business practices. Every student of the subject of marketing is aware of the difficulty of securing a perspective on the development of marketing methods and practices. Even such fragmentary clues as are afforded by some of these cases, therefore, are likely to be serviceable in later years for analyzing the development of marketing methods. No apology is offered for the numerous shortcomings of these cases. Those shortcomings serve rather to indicate partially the magnitude of the task still to be accomplished in acquiring a broad, scientific knowledge of this field of business management.

For some of the cases the decisions reached by the companies were recorded; for other cases merely the problems were presented; but in every instance I have expressed my conclusions regarding the case in the light of the evidence presented.

Melvin T. Copeland

Cambridge, Massachusetts, September, 1926

ALPHABETICAL LIST OF CASES[1]

[1] With the exception of a few cases, fictitious names have been used for the purpose of disguise.

HARVARD BUSINESS REPORTS

VOLUME 3

HARVARD BUSINESS REPORTS

Tuxbury Chain Company[1]

MANUFACTURER—STEEL ROLLER CHAINS

Sales Organization—*Establishment of Sales Branches as Alternative to Use of Wholesalers.* The company manufactured chains for use as plant equipment and as fabricating parts for trucks and implements. Manufacturers of trucks and implements and large industrial users preferred to buy directly from the company. The company made 40% of its sales directly. The remainder it made to wholesale distributors. The executives were of the opinion that aggressive sales methods were needed, particularly in view of the action of one competitor in establishing sales branches. It was proposed, therefore, that the company establish sales branches.

(1923)

A sales analysis made in 1923 showed that the high-grade, machined steel roller chains which the Tuxbury Chain Company manufactured in approximately 100 designs were used by 125 industries either for the transmission of power in plant operations or for incorporation into machines manufactured. Annual net sales fluctuated from $1,000,000 to $1,500,000.

The Tuxbury Chain Company divided its products into two general groups: chains for use as drives on automobile trucks, cement mixers, road machines, agricultural machines, and other implements; and chains for power transmission on mine locomotives, canning machines, coal stokers, textile machines, tool machines, and similar machinery. The company's sales were distributed approximately as follows:

Type of Chain	Percentage Distribution
For use in plant equipment:	
Standard line—new equipment	55
Special order	5
Replacement	15
For use in trucks and implements:	
Standard line—for new products	20
Replacement	5

[1] Fictitious name.

Automobile and implement manufacturers and also industrial users who purchased chains in large quantities preferred to buy directly from the company. Automobile manufacturers who purchased Tuxbury chains as fabricating parts for their products customarily ordered in advance of their needs, except in periods of business depression. Implement manufacturers usually purchased only for immediate needs. Direct sales made up 40% of the total sales volume. The company sold to the smaller industrial users chiefly through 28 mill supply firms located in industrial centers. It sold chains for replacements on trucks and implements to automotive, farm implement, and hardware wholesalers who, in turn, sold to garages and retailers. As a modification of this system of distribution, the sales manager of the company proposed the establishment of sales branches. His plan was submitted to the vice-president in charge of sales.

Industrial customers who purchased chains for use on machines in their plants ordered when new machinery was installed or when existing drives wore out. Many of these orders from industrial users ranged in amount from $25 to $50. The company seldom received orders from an individual industrial user more than twice a year. Frequently these customers required engineering advice. The Tuxbury Chain Company endeavored to provide this service through five engineer salesmen whom it sent to customers' plants when it received requests for advice, either directly or through wholesalers; the company employed no other salesmen. When there was not enough technical advisory work to keep the five salesmen occupied, they made visits, for purposes of sales promotion, to mill supply firms, automobile and implement manufacturers, and industrial customers who purchased directly from the factory, but no orders were solicited on these visits.

Requests for the manufacture of special types of chains were made directly to the company. In many instances, the company suggested slight changes in the designs submitted by a customer, in order to reduce the cost of manufacturing the special type of chain ordered. These recommendations frequently were made by correspondence. Though constituting but a small part of the total sales volume, special orders were profitable and appeared to be increasing in number. The four major competitors of the Tuxbury Chain Company were making no calculated effort to

appeal to this market. The experience of the company had been that on the average one type of chain out of each 100 manufactured on special orders was worth adding to the standard line.

The 28 mill supply firms maintained stocks ranging in amount from $5,000 to $15,000, the size of the stocks depending upon the requirements of the locality served. Four of the 28 distributors had exclusive agencies for Tuxbury chains. These firms received commissions on all sales of Tuxbury chains in their respective districts, except sales to truck or implement manufacturers for incorporation in their products. The company gave the other 24 firms special discounts which permitted them to sell Tuxbury chains in their own localities at an advantage over other wholesalers. The effect of this preferential discount was to restrict sales largely to the favored distributors. All Tuxbury distributors had stocks of supplies other than chains for sale to the industries in their districts. For example, a distributor in the South sold a variety of supplies for textile mills. The Tuxbury Chain Company suggested that its wholesale distributors take a 20% gross margin on Tuxbury chains. The company believed this to be lower than the distributors' average gross margin on other items. There was no assurance of uniform price quotations in each district. It was unlikely, however, that selling prices would be higher than those suggested by the company.

The plan proposed by the sales manager called for the immediate establishment of 5 branches in the more important districts and for a gradual increase of that number to 15. The sales manager believed that the company would need 15 branches eventually if it were to secure the benefits from aggressive selling. The branches were to sell all types of Tuxbury chains.

The average inventory necessary for each branch was estimated at $20,000. The Tuxbury Chain Company always had maintained from 60 days' to 90 days' stock at the factory for the benefit of the wholesale distributors, and, even with a branch organization, a factory stock department would have to be maintained. It was not feasible to ship parts to a branch and assemble chains there as ordered, because of the highly skilled labor necessary for assembling; a man skilled in assembling one design commonly was not adept in assembling another. It was likely, however, that the amount of stock carried at the factory could be reduced after the branch organization was firmly established.

The manufacturing period varied, according to the size of chain, from 5 days to 2 weeks.

Average estimated sales per branch were $40,000 for the first year. The annual minimum fixed expense for the proper administration and operation of each branch was estimated at $12,000; this figure included the salary of an engineer salesman. The company expected that sales could increase 50% per branch without affecting expenses appreciably. Each suggested branch territory included from 500 to 1,000 industrial users of chains and approximately 500 dealers in automotive equipment. About one-fourth of those firms already used or sold Tuxbury chains. The sales manager proposed that the control of credits and collections be decentralized also.

The sales manager was of the opinion that increased sales volume must come principally from small industrial users and from manufacturers who incorporated Tuxbury chains in their products. Availability of stocks of standard chains for immediate service in case of breakdowns was an influential selling point in obtaining orders from small industrial companies which could not afford to maintain supplies of chains as insurance against loss of time. Large industrial users commonly maintained reserve stocks of chains at their plants.

One competitor of the Tuxbury Chain Company operated 6 branches with complete stocks and 16 branches without stocks. This competitor also had wholesale distributors in territories not served by the branches. In the districts where this competitor operated branches with stocks, sales of Tuxbury chains had not increased so rapidly as in other districts. Observation of developments in other industries indicated that the establishment of sales branches frequently became general when one manufacturer took the lead.

Commentary: Forty per cent of the company's sales already were made directly to manufacturers and industrial users. The direct sales included practically all the chains sold to manufacturers of trucks and implements (20%) and all the special order sales for plant equipment (5%). The balance of the direct sales (15%) included chiefly standard chains for new equipment in factories. The sales to distributors (60%) included standard chains for plant equipment (40%), replacements of

plant equipment (15%), and repair parts for trucks and implements (5%).

The volume of business already included in the direct sales would not have been affected appreciably by the operation of sales branches. The sales of chains to wholesalers for resale to garages and retailers for repair purposes on trucks and implements also would not have been affected greatly, for it hardly would have been economical for the company to attempt to cater to the scattered, sporadic demand for chains bought usually in very small quantities by garages, repair shops, and other retailers.

The problem, therefore, was concerned primarily with 55% of the company's sales, including about three-fourths of the sales for new plant equipment and practically all the replacement equipment for plants. The advantages in establishing sales branches for this segment of the company's market briefly were as follows: The company already was maintaining a crew of five engineer salesmen whose services probably could have been utilized somewhat more advantageously under a branch system. The four firms of distributors which held exclusive agencies received commissions on direct sales of plant equipment made within their territories; the amount of these allowances would have been saved to the company by the establishment of sales branches. An eventual reduction in factory stocks was anticipated, which would partially have offset the cost of carrying stocks in the branches. Control over branch stocks might have resulted, in occasional instances, in better service to customers on repair parts. The distributors were selling other kinds of merchandise and consequently could not give to Tuxbury chains the undivided sales attention that could have been given by the employees of a sales branch. As is usual in such cases, the establishment of sales branches would have made possible the readier utilization of aggressive sales methods, and in this particular instance would have aided in combating the activities of the competitor who had established sales branches. The fact that the company's sales had not increased so rapidly in the districts in which the competitor carried stocks as in other districts afforded evidence that a menace existed.

The advantages to be gained from the establishment of sales branches were offset, in part at least, by the advantages that were present in the system of distribution through mill supply firms. Price was a real factor in the purchase of such equipment by manufacturers. No evidence is presented which proves that the company could sell chains through its own branches more economically than they were distributed by wholesalers. On the contrary, the fact that the usual order of chains for new plant equipment was small, \$25 to \$50—and the

ordinary order for replacement purposes presumably was much smaller —placed a limit on the amount of direct sales effort which economically could be expended in securing each order. A distributor was spreading his sales expenses over a wide variety of articles. It was inevitable, furthermore, that small scattered companies should have comprised an appreciable portion of the potential industrial market for chains outside of the users who bought directly from the Tuxbury Chain Company. The expense of reaching these small purchasers directly to sell merely chains would have been prohibitive. The estimated expense of operating the branches during the first year was 30% of sales, whereas the distributors' margin was 20%. If the average sales per branch could have been increased to $60,000 without any increase in expense, the operating ratio would have been reduced to 20%, but such a result was altogether improbable. Thus, the establishment of sales branches would have been likely to necessitate an increase in prices or a fall in profits.

A purchase of chains for new equipment was made by each user at infrequent and irregular intervals. For repair parts the demand was sporadic. For a chain manufacturer's salesman, therefore, many calls would not be productive, at least at the time when the calls were made. The purchases of such equipment were governed by factors, such as the demand for the users' products, which the chain manufacturers could not influence. The demand for chains, moreover, was likely to be subject to wide fluctuations with changes in general business conditions; in periods of slack demand the expense of maintaining sales branches would have constituted a heavy burden on the Tuxbury Chain Company.

Reference was made in the statement of the case to the advantage of being able to make quick deliveries to customers. With the cooperation that fairly could have been expected from the distributors, the 28 distributors should have been able to make quicker deliveries to customers in many instances than could have been made by 5 to 15 sales branches; the more numerous distributors were more easily accessible to at least a portion of the customers.

The importance of the special-order business also was stressed. Inasmuch as special orders constituted but 5% of the company's sales, however, that portion of the business should not have been permitted to dominate the sales policies, nor is it by any means certain that it would have been advantageous to increase the special-order business greatly.

This product was one for which demand for use as equipment in small plants could not be expanded rapidly by the use of aggressive sales methods, and the company already was dealing directly with large

customers. Although there unquestionably were gains to be made in some directions by the establishment of sales branches by this company, those gains would have been more than offset by the disruption of the company's existing methods of distribution. Other means of combating competition and of promoting sales should have been sought.

January, 1926 M. T. C.

Collis Belting Company[1]

MANUFACTURER—LEATHER BELTING

Sales Organization—*Discontinuance of Sales Branches by Manufacturer.* For several years prior to 1921 the company, which manufactured industrial belting, had operated five wholesale branches; it also had sold to mill supply firms and directly to large users of belts. During the period of depression in 1921, the operating expenses in the sales branches were so high that the company closed three of the branches. In the districts in which those branches had been operating, the company appointed mill supply firms as exclusive agents for its products. In 1924 the two remaining branches were operating at a loss; it was proposed, therefore, that they also be closed.

(1924)

In 1924 the Collis Belting Company, which manufactured single- and double-ply, high-grade industrial belting in more than 30 sizes, was distributing its output nationally through 28 mill supply firms, 2 sales branches, and 9 salesmen who operated from the home office in Indiana. At that time approximately 20% of the company's sales were made to sawmills, 10% to cottonseed oil mills, 30% to steel mills, 10% to railroad shops and roundhouses, 10% to automobile manufacturers, and 20% to a miscellaneous group of industries among which textile mills were the largest purchasers.

From 1921 to 1924 the expense of maintaining the sales branches had been approximately 20% of their sales. Executives of the company were of the opinion that the expense should have been but 10% of sales and, for that reason, contemplated discontinuing those branches as they had discontinued three others in 1921.

In 1921 the company had been operating five sales branches, at Richmond, Birmingham, Fort Worth, Seattle, and New Orleans. The company at that time also had sold through 25 mill supply firms to which it granted exclusive agencies and through its own salesmen who made their headquarters at the home office.

A few of the mill supply firms purchased both single- and double-ply belting outright; a majority, however, purchased mini-

[1] Fictitious name.

mum stocks of single-ply belting outright and took stocks of double-ply belting on consignment. The mill supply firms assumed the credit risks on all sales which they made. They also sold canvas and rubber belting and such supplies as oil waste, pulleys, and hangers; they agreed, however, not to sell the leather belting of any other manufacturer. On belting which they purchased outright they planned to secure a gross margin of from 15% to 20% when competitive conditions permitted; their commission on sales of consigned stock was 10%.

Supplies of belting were stored at the sales branches in order to facilitate deliveries to customers. In 1921 the sales branch at Richmond maintained a stock of $48,000; the branch at Birmingham a stock of $30,000; the branch at Fort Worth a stock of $30,000; and the Seattle and New Orleans branches each a stock of $20,000. The company could save in freight charges by making shipments of rolls of several thousand feet of belting to the branches; each piece of belting had to be wrapped in water-proof paper. Large rolls of belting, moreover, received the same freight classification as small rolls. In no instance were the sales of any one sales branch large enough to make carload shipments to it advisable. A shipment of approximately $40,000 worth of belting was needed to secure carload rates. Usually from two to four salesmen and one belting repair man made their headquarters at each branch office. One of the salesmen acted as branch manager. A belting repair man was employed to furnish installation and repair service to customers and to prepare special belts in emergencies. This latter type of work, however, was required infrequently.

Prior to 1921 the annual rate of stock-turn at each branch was from 4 to 5 times, and the average sales expense was between 10% and 12% of sales. Sales expense included rent of sales rooms, salaries of salesmen, salaries of belt repair men, and supplies which were necessary to the maintenance of the branch. Until 1921, the company was satisfied with the performance of its branches. Distribution through the branches was less expensive than distribution by salesmen operating from the home office. The sales expense of the branches also was less than the customary gross margin which the mill supply firms secured on the belting which they purchased from the company, and about equal to the rate of commission which the company paid to the mill

supply firms on sales of consigned stock. In 1921, however, the rate of stock-turn for each branch was about 2.5, and the sales expense was approximately 20% of sales. The company could not afford to operate five branches at a loss. Consequently it discontinued all branches except those at Seattle and Birmingham. Those it continued even though they showed losses, for the averred reason that the industries located in and near Seattle and Birmingham required prompter delivery than could be furnished by freight from Indiana.

In each of the three districts where sales branches were discontinued the company appointed a mill supply firm as its exclusive agent. The arrangements made were similar to those between the company and its other mill supply distributors. Three of the company's salesmen traveled from the Seattle branch, three from the Birmingham branch, and nine from the central office to parts of the United States not served by those two branches or by mill supply firms with agencies for Collis belts.

The salesmen were paid salaries or commissions, the amount and type of payment being agreed upon by each salesman and the sales manager. Usually the type of payment depended upon the preference and ability of the salesman. The company believed that the total direct sales expenses of a salesman should be less than 10% of the amount of his sales.

A salesman might secure an order for a $5 belt from a manufacturer one month, and on his next call he might sell the manufacturer $5,000 worth of belting. The number of the company's customers was not large enough and the range in the size of orders was too great to permit a significant average sale per customer to be computed. The frequency with which a salesman called upon his customers depended upon the number of customers in his territory; on an average he called on each customer from four to six times a year. Purchasers sometimes asked belting salesmen to specify the type, width, and quality of belts to be used; hence, it was essential that belting salesmen have some technical knowledge. Some of the selling points stressed by the Collis Belting Company's salesmen in influencing industrial purchasing agents were quality of material, skill of workmanship, promptness of delivery, and price.

The company advertised in trade publications of the industries to which a majority of its belts were sold. Competition in the

belting industry came from two types of manufacturers: large manufacturing companies with central offices at their factories and sales branches at strategic points throughout the United States; and small manufacturers who confined their operations to one or two industrial centers. It was possible to manufacture belts with as small an investment of capital as $500; consequently, many companies were established which were not financially able to maintain varied stocks of high-grade belting at all times.

It had been the experience of the Collis Belting Company that the amount of its sales depended upon general business conditions. When the demand for manufactured products decreased, some of the machines in factories became idle. In order to reduce expenses, the plant superintendents used the belts from the idle machines instead of purchasing new belts to replace those which were worn out. Ordinarily, manufacturers to whom the Collis Belting Company sold did not maintain stocks of belts to meet emergencies. The company frequently was called by telephone and asked to quote a price on a belt which a manufacturer desired to have replaced. The company's customers stressed price in making their purchases and also commonly took into account the time required for delivery and their past dealings with the company.

Since the two remaining sales branches had continued to be unprofitable, the company, in 1924, was considering the advisability of discontinuing them. In both Seattle and Birmingham there were several mill supply firms. The Collis Belting Company had not investigated to determine whether any of these would sell its products on an exclusive agency basis.

Commentary: In the commentary on the Tuxbury Chain Company case[2] reference was made to the probability that in periods of depression sales of equipment such as that which the company produced would fall to a low amount, with the result that the company's wholesale branches would incur heavy operating losses. The soundness of that conclusion is exemplified in the experience of the Collis Belting Company.

The Collis Belting Company should have discontinued the two remaining branches in 1924. The reasons for discontinuance were

[2] See page 6.

essentially the same as those against the establishment of sales branches by the Tuxbury Chain Company.

The questions as to whether exclusive agencies should have been granted and as to whether stocks should have been consigned to mill supply firms were not specifically raised as issues in this case; hence no comment is made on those points.

March, 1926 M. T. C.

Keane Motor Car Company[1]

MANUFACTURER—AUTOMOBILES

Distribution Channels—*Retailers Utilized in Preference to Wholesalers.* Like many other automobile manufacturers, this company had marketed its product prior to 1922 through wholesale distributors who also sold at retail in the cities in which their stores were located. The distributors had selected the local retailers to whom agencies for Keane cars were to be granted, and had been expected to secure maintenance of satisfactory auxiliary service by the dealers. The distributors also had helped to finance the manufacturer's operations by advance payments. In 1922 the company concluded that in numerous instances the distributors were not exercising proper care in the selection of local dealers or in the supervision of the dealers' service standards. The company, therefore, decided to undertake gradually to sell directly to local dealers.

Sales Organization—*Establishment of Sales Branches as Alternative to Selling Directly from Factory.* When the company, which manufactured high-grade automobiles, decided in 1922 to undertake gradually to supplant the services of wholesale distributors by selling directly to retailers, it decided to make the sales directly from the factory instead of operating wholesale branches.

(1922)

In 1922 the Keane Motor Car Company was convinced that in order to increase its sales it should change its method of distribution. Two plans were suggested: (1) selling directly to retailers from the factory; and (2) establishing wholesale distributing branches.

The firm manufactured a high-grade eight-cylinder car, in both open and closed models, which sold at retail for $2,500 to $4,250. The annual output of the company was 3,000 automobiles. These automobiles were sold through 40 distributors. Besides selling Keane cars at retail in the city where the distributor was located, each distributor served as wholesaler for an allotted territory which in individual cases ranged in size from 12 counties to 3 states. Each distributor selected the retailers to whom to grant Keane agencies in his territory. In 1922 Keane cars were sold by 350 retailers in addition to the distributors. Of the total number of dealers and distributors, all but 20 also sold cars which were lower in price than Keane cars. The discount to

[1] Fictitious name.

distributors was 30% or 35% off the retail list prices; the higher discount had been granted to only a few distributors whom the company had been especially desirous of serving.

In order to obtain intensive solicitation and to standardize the service given to owners, a few other automobile manufacturers were changing their methods of wholesale distribution. The Rose Motor Company,[2] which manufactured a line of six-cylinder cars ranging in price from $1,500 to $2,300, had established wholesale branches. The Frink Motor Company,[2] with a car in the price class of the Keane car, in 1920 had recalled all distributors' contracts and established its own wholesale branches. In 1922 it was reported that this company was attempting to reestablish a system of distributors. The failure of the experiment of the Frink Motor Company was attributed to the inferior performance of its car rather than to the distributing method. In fact, it had been rumored that the company had been forced to establish its own branches because of the difficulties experienced by distributors in inducing retailers to handle its car. Toward the close of 1922 one of the largest manufacturers of popular-price cars was stated to have begun establishing wholesale branches; this company produced six-cylinder cars in light and heavy models.

The experience of the Keane Motor Car Company had been that often a distributor did not spend enough time on the selection and education of retailers in his allotted territory; his efforts were directed principally at increasing his own retail sales. The company, furthermore, had little control over the standards of service rendered by retailers and could not insure uniform treatment to Keane owners. One of the advantages in selling through distributors originally had been the financial assistance obtained from the advance payments, or at least payments on delivery, made by the distributors for the cars ordered. During 1920, however, this method of payment had been changed because of the stringency of credit among distributors and retailers, and beginning in that year the company had shipped all cars on consignment.

If the company were to establish wholesale branches, a large financial outlay would be required in order to obtain suitable locations and to stock each branch with a full line of cars and

[2] Fictitious name.

parts. The company had one wholesale branch which had been established in order to maintain continuous representation in a large city after the financial failure of the authorized distributor. Operating costs of this branch had been higher than those of distributors, but the company's good-will had been augmented, it was stated, through the excellence of service rendered.

The company would experience more difficulty in controlling and standardizing the service given consumers by dealers if it sold directly from the factory than if it sold through wholesale branches. The direct-to-retailer plan, however, could be expected to encourage intensive solicitation by the retailers, since the discount allowed to them by the company would be higher than under a system of wholesale branches. If no branches were established, furthermore, it was probable that many of the 40 distributors could be induced to continue to sell Keane cars at retail in their respective localities.

Neither plan, in its entirety, could be put into effect immediately. If factory branches were decided upon, the transition necessarily would be gradual and might be deemed a menace by the distributors not affected at first, thereby causing them to give up their Keane contracts prematurely. The company accordingly decided to sell directly to retailers from the factory, putting the policy into effect gradually; so long as a distributor was securing satisfactory results from the dealers in his territory, he would be permitted to continue to act as a distributor.

Although the direct-to-retailer plan made possible more intensive cultivation of several territories, it was difficult to persuade small retailers to stock adequate supplies of parts for repairs. It appeared, furthermore, that the distributors whose contracts were not taken away began to pay more attention to the development of their wholesale business.

Commentary: The policy which this company followed prior to 1922 in utilizing the services of wholesale distributors was common in the automobile industry. The industry had grown rapidly, and technical improvements had followed one another in rapid succession. Under these circumstances it was not surprising that the manufacturers had tended to devote more attention to production problems than to sales policies. The system of wholesale distributors had evolved because the distributors had been willing to take charge of many of the

troublesome distribution problems and also because the distributors helped to furnish operating funds for the rapidly expanding business.

After the crisis of 1920, however, a change in the automobile market began to appear. In the particular instance of the Keane Motor Car Company, the distributors ceased to make advance payments. At the same time, with the stress of keener competition, the shortcomings of the distributors in the selection and supervision of local dealers became more apparent. That those shortcomings existed was not at all surprising.

Under the system of selling through wholesale distributors, it was to be expected that some firms of distributors would perform all their functions satisfactorily. It also was to be expected that a substantial proportion of the distributors would not meet the company's requirements under keenly competitive conditions. A distributor had a divided interest, between his own retail sales and sales to local dealers. It was almost inevitable that some distributors would be successful retailers but rather poor wholesalers. The two types of business were quite different. The proper selection of local dealers, however, was essential for the continued prosperity of the manufacturing company. It was equally essential that satisfactory standards of repair service be maintained by those dealers, for the attitude of car owners toward a particular make of car was influenced strongly by the dependability of the upkeep service furnished by the local dealers.

The selection of dealers and the supervision of their service standards were of such great consequence to the company that it could not safely continue to delegate those functions to distributors except in instances where the distributors had proved fully their ability to accomplish satisfactory results. In other districts it was a safer plan for the company to take over the wholesale function itself than to experiment with new distributors.

Although the company undertook to sell to local dealers directly from the factory, its difficulties in persuading numerous small dealers to carry complete stocks of repair parts indicated that branch warehouses were likely to be required.

March, 1926 M. T. C.

Rawlings Motor Car Company[1]

MANUFACTURER—AUTOMOBILES

Distribution Channels—*Retailers Utilized in Preference to Wholesalers.* The company, which manufactured low-price passenger automobiles and trucks, decided to discontinue selling through wholesale distributors and to sell directly to retail dealers. It was the company's opinion that the wholesale distributors failed to give their dealers adequate assistance and encouragement. The company's sales volume increased greatly following the change in the method of distribution.

(1922-1924)

The Rawlings Motor Car Company manufactured passenger automobiles and trucks which, in 1922, ranged in price from $395 to $795. The company operated assembling plants in New York, Wisconsin, Michigan, Missouri, and California. The sales manager of the company estimated that with adequate sales effort the company could achieve a sales volume in 1922 of 1 automobile to every 500 of the population of the United States. Although that sales volume was more than three times as large as the company's sales volume in any previous year, the executives deemed the estimate sound and decided to plan 1922 sales in accordance with it. When this decision was made, the sales manager proposed that the company, in order to provide for closer control of sales and for more aggressive merchandising, begin to sell directly to retailers.

At that time the Rawlings Motor Car Company was selling to 20 wholesale distributors. The company's terms were cash less 20% less 10%. Those distributors had well-defined territories and, in turn, sold to about 1,500 retailers. The distributors also maintained retail departments. Under the existing method of distribution, annual sales of Rawlings automobiles in the various districts ranged from 1 to every 2,500 of the population to 1 to every 1,500 of the population, the ratio depending chiefly, the sales manager believed, upon the aggressiveness of the distributors and of their retail dealers.

Although its sales had increased annually, the Rawlings Motor Car Company had been dissatisfied with its plan of distribution

[1] Fictitious name.

for several years. The executives were of the opinion that the distributors were failing to give their dealers adequate assistance and encouragement. The Rawlings Motor Car Company did not maintain a sales force large enough to help dealers in arranging displays in their showrooms, in operating service departments, in setting up suitable accounting systems, or in deciding upon sales policies and other policies. Instead, the company granted distributors a discount of 10%, in addition to the regular 20% discount, in order to enable them to provide sales help for retailers.

The company believed that the distributors failed to stock automobiles in large enough quantities. They stocked only enough for their own retail departments and for a limited number of their dealers. A distributor, consequently, sometimes could give more prompt delivery to a consumer than could the dealer in whose territory the consumer was located. As a result, distributors occasionally sold to their dealers' customers.

The sales manager proposed that the company sell directly to 5,000 retailers with exclusive agencies in their respective districts. According to his plan, the company would sell to the retailers for cash on delivery at the same prices at which the wholesale distributors had been selling to retailers. It was probable that the 20 distributors could be retained as retail agents for Rawlings cars. With 5,000 dealers, or about 1 for every 20,000 persons in the United States, the 1922 sales quota for each would be about 40 automobiles, including trucks. The company would ship automobiles to its dealers at regular intervals. The sales manager did not anticipate any difficulty in securing the number of dealers needed, since the sales quota to be assigned each dealer called for a comparatively small outlay of capital by the dealer.

The sales manager was of the opinion that the company, if it sold directly to retailers, might find it necessary to maintain a sales force of 450 men and to establish sales offices, without stocks, throughout the United States to assist in distribution and to give aid to retailers.

The Rawlings Motor Car Company in 1922 adopted the policy of selling directly to retailers. In 1923 the company sold to 7,000 retailers. Those retailers employed approximately 20,000 salesmen, to whom they paid commissions. During 1921, the last year in which the old policy of distribution was in effect, the

Rawlings Motor Car Company sold 77,000 automobiles, or approximately 1 to every 1,300 of the population of the United States. During the first year under the new policy, the company sold 242,000 cars, or about 1 to every 430 of the population; and during 1923 the company sold 483,000 automobiles, or approximately 1 to every 220 persons. The company's production schedule for 1924 called for 1 automobile to every 131 of the population. The quotas assigned to the dealers, however, were on the basis of 1 automobile to every 100 persons.

COMMENTARY: This company's problem was essentially the same as that of the Keane Motor Car Company.[2] The Rawlings Motor Car Company, however, laid particular stress upon the opportunity for applying greater sales pressure under a policy of direct sale than could be applied through intermediaries such as the wholesale distributors. The results indicate that the company's decision was sound, and the experience recorded in this case supports the general conclusion reached on the Keane Motor Car Company's case.

March, 1926 M. T. C.

[2] See page 15.

Blackstone Company[1]

WAREHOUSE DISTRIBUTOR—IRON AND STEEL

Warehousing—*Establishment of Warehouses to Meet Competition.* It was suggested that the company, a warehouse distributor of iron and steel products, should establish additional warehouses in territories already served by its existing branches. Those territories also were served by competitors, and in some instances the company was at a competitive disadvantage because of freight differentials resulting from the location of its warehouses.

(1920)

In 1920 the Blackstone Company, one of the largest warehouse distributors of iron and steel products in the United States, had warehouses in St. Louis, Detroit, Buffalo, New York, and Chicago. The company, at that time, contemplated the establishment of additional warehouses in Boston, Cleveland, Cincinnati, Philadelphia, and other cities which it then served from its existing warehouses.

The Blackstone Company, like other warehouse distributors, bought iron and steel products in large quantities, stored them, and then sold them in small quantities to meet customers' requirements. The Blackstone Company paid the same prices to steel manufacturers as were paid by large users buying directly from the manufacturers. In accordance with the Pittsburgh Basing Point system, the manufacturers' prices included freight charges for the distance from Pittsburgh to the points of destination. The Blackstone Company's selling prices were $15 per ton higher than the prices paid to the manufacturers. The company took the cash discounts offered by the manufacturers, the terms being ½ of 1% 10 days, net 30 days.

The Blackstone Company and the steel mills sold to practically the same classes of customers, including railroads and other transportation companies, automobile manufacturers, oil companies, and building contractors. Frequently a building contractor bought steel for the basement and first floor of a new building from the Blackstone Company for immediate delivery and, at the same time, ordered steel for the rest of the building from steel

[1] Fictitious name.

mills. In this way the builder had stocks of steel on hand as required. The Blackstone Company also sold large quantities of material for plant maintenance. Small machine shops and similar establishments purchased from the Blackstone Company. The company did not compete with the steel mills; it took small orders which would not have been profitable to the mills. About 12% of the entire steel output of the United States was handled through warehouse distributors.

The Blackstone Company sold a general line of iron and steel products for fabricating and manufacturing purposes, including structural steel, plates and bars, tubes, and black and galvanized sheets. It also sold specialties such as high-speed steel; tool steel, which frequently was purchased in very small lots; and machinery and boiler specialties, including flanges, braces, hangers, and tube expanders. The company did no fabricating. Its total sales amounted to about $10,000,000 annually. The company had built up its sales volume mainly on the basis of the service which it provided. It carried a complete line and was able to make deliveries immediately upon receipt of orders. Orders placed with steel mills ordinarily had to be manufactured according to specifications before shipment. There were many small warehouse distributors which carried only partial lines.

The districts in which the Blackstone Company considered establishing warehouses in 1920 were being served by warehouses of competitors, but the standard of service maintained by those competitors was not equal, the executives of the Blackstone Company believed, to that of the Blackstone Company. The Blackstone Company, for instance, carried wider plates and heavier machinery for cutting those plates than did most of its competitors. The industries in those districts were such as to require the services of warehouse distributors like the Blackstone Company. If the company established the proposed warehouses, however, the territories served by its New York, Buffalo, Detroit, and Chicago warehouses would be curtailed and intensive sales efforts would be necessary in those territories to offset the consequent loss in their sales.

Without the additional warehouses, the Blackstone Company, in selling in Boston, Philadelphia, Cleveland, and Cincinnati, was at a disadvantage as compared with local distributors, because of

the freight differentials. On sales in those cities local distributors had to pay freight charges only for the distance from Pittsburgh, whereas the company, when it sold there, had to pay freight charges for the distance from Pittsburgh to its warehouses and thence to the locations of the customers. The manufacturers' prices in Philadelphia, for example, were 2 cents per ton less than the New York City prices, because of the lower freight charges on shipments to Philadelphia under the Pittsburgh Basing Point system. The prices in Trenton, New Jersey, were the same as in New York.

Commentary: The chief advantage which the company would have gained by establishing branches at the points proposed would have accrued from the savings in freight charges on materials which it sold for delivery in regions adjacent to those points. Those savings would have been small, however, as instanced by the Philadelphia–New York differential; and the company did not obtain orders primarily by offering low prices.

To warrant establishing a new warehouse at any point, it was essential that the company be assured of a sufficient volume of sales in that district to absorb the operating expenses of the warehouse. The company also had to reckon with the potential loss in the volume of sales in the remainder of the district from which the new district was carved. These conditions led to a consideration of the nature of the demand for the materials sold by the Blackstone Company.

The company maintained its existence by selling iron and steel in smaller lots than could be purchased directly from the iron and steel manufacturers, and by carrying stocks of materials from which immediate deliveries could be made to users who could not conveniently await deliveries from the mills. The company could increase its sales as industrial expansion occurred or by cutting into the sales of competitors. It could not, however, by aggressive sales methods increase appreciably the aggregate quantity of iron and steel used in any district. The ultimate demand for iron and steel was beyond its control. As the demand for iron and steel increased in any district, furthermore, some customers were likely to increase the volume of their purchases to quantities that could be bought directly from the mills, thus limiting the share of the total iron and steel business which the wholesalers could obtain.

The company could not expect to compete with the iron and steel mills for large orders on which immediate delivery was not required. Unless extraordinary business conditions obtained in a particular dis-

trict, therefore, the company could not expect to increase the volume of its sales rapidly in that district. No evidence was offered to indicate that a rapid expansion of the iron and steel market was impending in any of the districts in which it was proposed that the company should establish new warehouses. Nor was evidence offered to indicate that the company had attained a volume of sales in any of these districts which was adequate to support a warehouse. In the absence of such evidence, the warehouses should not have been established. Under the limitations on the potential expansion of the company's market, the growth of sales should have reached a volume approximately large enough in any district to support a warehouse before the warehouse was established. In this instance, the major increase in volume of sales should precede rather than follow the establishment of a warehouse.

May, 1926 M. T. C.

Intervale Supply Company[1]

MANUFACTURER AND WHOLESALER—JANITORS' SUPPLIES

Merchandising—*Discontinuance of Unprofitable Supplementary Merchandise.* The company manufactured janitors' supplies which it sold to wholesalers and directly to retail stores, offices, schools, and other institutions. In order to facilitate direct sales of its own products, the company purchased allied merchandise from other manufacturers for resale. The merchandise purchased for resale appeared to be unprofitable, however, and the company decided to discontinue the purchase of resale merchandise and to sell its own products through supply firms and wholesalers.

Distribution Channels—*Wholesalers and Supply Firms Utilized in Preference to Direct Selling.* The company sold a complete line of janitors' supplies, some of which it manufactured and some of which it purchased for resale from other manufacturers. The company made the larger part of its total sales directly to retail stores, offices, schools, and other institutions. It made more than half the sales of the products which it manufactured, however, to wholesalers. After the company discontinued purchasing for resale, because purchases of resale merchandise appeared to be unprofitable, it decided to discontinue direct selling and to market its products through wholesalers and supply firms.

(1924-1925)

The Intervale Supply Company of Minneapolis sold a complete line of janitors' supplies throughout Minnesota and northern Wisconsin. In 1924 this line consisted of 14 divisions of products. The products in some divisions were made in various grades and sizes so that the company sold in all approximately 120 items. The company manufactured but 20 of these 120 items. The rest it purchased from other manufacturers and sold at wholesale. Although the company had experienced losses on products purchased for resale, the executives were agreed that, in view of technical obstacles and the additional space and machinery that would be required, it would be unwise for the company to manufacture products similar to those purchased for resale.

The Intervale Supply Company had been incorporated in 1909. At that time its activities had been limited to the manufacture of sweeping compounds and floor oils. Two salesmen had been

[1] Fictitious name.

employed to solicit orders from the purchasing agents for schools, office buildings, and unit stores. Those salesmen had requested the company to add brooms to its line, since brooms could be sold at the same time that orders were obtained for the other products. The company had granted this request and also subsequent requests made by the salesmen for additional allied products. Those supplementary products were toilet paper, paper towels, polishes, waste-baskets, dusters, and fumigators. The company purchased those items from other manufacturers for resale.

The number of lines of products manufactured gradually had increased until, by 1924, the company manufactured not only sweeping compounds and floor oils but also disinfectants, liquid soaps, washing compounds, water softeners, inks, cleaners for lavatories, paste soaps, and a compound for opening drains. The Intervale label was placed on six products; the others had different trade-marks. Sales by divisions of products for 1922, 1923, and the first five months of 1924 are shown in Exhibit 1. The gross margin percentages in the exhibit were based on direct factory costs or purchase prices. In computing net profit, the sales manager made an arbitrary allocation of factory overhead, general expense, and sales expense to each product division. Sales resistance and the proportion of a division's sales to total sales influenced the allocation of those expenses. The expense of advertising specific products, however, was charged directly to the products advertised.

A small net profit was shown for 1922 and 1923. The first five months of 1924 showed a small loss. This was not unusual, however, because salesmen spent considerable time during the first part of each year obtaining from schools orders to be filled three or four months later. Those sales were not shown in the records until deliveries were made.

The company had 14 salesmen who sold the entire line of products directly to retail stores, office buildings, schools, and other institutions. One specialty salesman was employed to introduce new products. All the salesmen were paid salaries and expenses. One of the 14 salesmen solicited orders from only those firms which never had used the company's products. It was impossible for the salesmen to visit all the prospective customers in their assigned territories, and the general manager was of the

Exhibit 1

Net Sales of Intervale Supply Company for 1922 and 1923 and Net Sales, Gross Margin, and Net Profits for Five Months Ending May 31, 1924, by Divisions of Products

Products	January 1—May 31, 1924			1923	1922
	Gross Margin	Net Profit	Net Sales	Net Sales	Net Sales
Sweeping compounds*	58%	13%	$ 10,364.01	$ 21,203.54	$ 20,771.29
Floor oils*	65	20	1,688.42	3,994.99	3,401.90
Disinfectants*	35	9‡	4,935.97	7,036.05	5,970.61
Liquid soaps*	68	23	5,027.52	9,974.89	10,003.53
Papers	15	10‡	53,857.37	107,655.29	98,368.71
Brooms and dusters	36	3‡	8,145.73	22,918.26	26,931.75
Washing compounds*	58	34‡	7,938.26	12,829.20	11,245.40
Fumigators and sulphur candles†	....	....	....	133.89	1,105.03
Inks*	56	11	321.06	1,643.18	1,602.23
Polishes	17	7‡	2,343.22	5,944.91	6,222.42
Sundries	22	18‡	20,894.20	50,707.40	36,380.17
Sanitary cleaners*	67	23	630.28	1,341.94	1,458.78
Cleaning powders*	68	57	521.05	350.82	1,069.70
Drain cleaner*	73	28	17,671.22	27,120.40	19,647.44
Paste soaps*	65	20	687.48	838.86	549.25
			$135,025.79	$273,693.62	$244,728.21

*Manufactured by Intervale Supply Company.
†Discontinued December 31, 1923.
‡Loss.

opinion that the company could not afford to enlarge the sales force. It usually required six months to train a new salesman, and the cost was approximately $1,200. The administration of the sales force took a large part of the sales manager's time. The sales manager also was in charge of advertising and assisted in purchasing.

The company sold several products to a few wholesalers. For example, it sold sweeping compound to several wholesale drug firms. This was the only product which those customers purchased from the company. The wholesalers frequently ordered by telephone. The company sold washing compound and the drain opener to 13 wholesale grocers and to 2 hardware wholesalers. The company had trade-marked and introduced those 2 items in 1923, and in 1924 was advertising them extensively in newspapers and directly by mail. The specialty salesman called on grocery and hardware retailers to introduce those new products.

All orders received by that salesman were turned over to wholesalers designated by the purchasers. The company made some sales, however, directly to industrial consumers who used those two products in quantities. For example, it sold water softener by the barrel to creameries. The price to wholesalers was 15% less than the price to those customers to whom direct sales were made. Sales to wholesalers in 1923 of the products manufactured by the company were $45,200. The company did not resell to wholesalers any of the products which it purchased from other manufacturers.

A salesman commonly made 10 calls a day on janitors or building superintendents of office buildings and schools, and 25 a day on purchasing agents for retail stores. Calls were made once a week in office buildings and once a month in schools. The average institutional order received, exclusive of paper, was $10, except for schools, which ordered only on competitive bid contracts for a year's supply. The retail stores were solicited once each 6 weeks and a majority of the orders received from them ranged in amount from $2.50 to $10.

The Intervale Supply Company had three competitors in the territory in which it operated. Those competitors had complete lines, but did not manufacture all the products which they sold. The Intervale Supply Company had exclusive rights for the distribution of several of the products which it purchased, but representation of the paper line was shared with competitors. It was the practice of the company's salesmen to use the paper line as a leader for securing orders. The company did not cut prices on the other products. The purchased articles, and particularly the paper products, required considerable warehouse space. The articles which the company manufactured were not made until orders were received; warehouse space for those products, consequently, was limited to that required for raw materials. In 1923 the company's average inventory was $35,500; of this, $12,500 represented the paper inventory.

The products which the company purchased for resale appeared to be unprofitable, but the salesmen contended that it was necessary to carry those items in order to make sales in other lines. The company at one time had instructed its salesmen to solicit orders for only those products manufactured by the company,

but the salesmen had reported that if such a practice were followed permanently they would lose customers such as the purchasing agents for office buildings and schools, who preferred not to split their orders. The company had not undertaken to investigate the attitude of customers toward full-line firms and toward specialty firms. It was the offhand opinion of the sales manager that unless the company continued to purchase merchandise from outside sources it would have to confine sales to wholesalers and, consequently, to dispense with the services of half a dozen salesmen.

Early in 1925, the company decided to discontinue the purchase of merchandise for resale and to market its own products through supply firms and wholesalers.

Commentary: The loss experienced by the company during the first five months in 1924 was at least partly seasonal and, therefore, not a cause for alarm; nevertheless, the company had earned only small net profits in 1922 and 1923 and there was no reason for expecting an improvement. The question of a change in sales policy, consequently, was pertinent.

In analyzing the data on sales, the first fact which should be brought out is that in 1923 over one-half the company's sales of its own products were made to wholesalers. The total net sales were $273,693. The sales of goods purchased amounted to $187,359. The total sales of products manufactured by the company were $86,334, which included sales to wholesalers amounting to $45,200. The sales to wholesalers comprised solely goods made by the company.

The purpose of purchasing merchandise for resale was to facilitate sales of the company's products for use in schools, office buildings, and institutions. Sales of the company's own products to that market amounted to $41,134, whereas the company's resales of merchandise purchased amounted to $187,359. The company, therefore, was handling $187,359 of resale merchandise annually at small profit or estimated loss to aid in selling its own products to the amount of $41,134.

If the company were to continue to purchase merchandise for resale as theretofore, it should have organized its business primarily as that of a firm of supply merchants, making its manufacturing operations incidental to its general merchandising business. If it were to operate as a manufacturing company, its decision to discontinue its purchases of merchandise for resale was sound; it could market its own products through supply merchants and wholesalers.

Over one-half its output already was being sold to wholesalers for

distribution to retail stores. That portion of its business would not be affected by the change in sales policy. For the remainder of its business in the sale of its own products, supply merchants offered facilities which the company could not duplicate. Customers normally would buy such supplies at frequent intervals in small quantities for immediate delivery. Since a firm of supply merchants was selling many other products, it ordinarily could be expected to secure orders and handle shipments of this type at lower cost and with prompter delivery than the transactions could be handled by a small manufacturer.

By selling its output entirely to supply merchants and wholesalers, the company could reduce its sales expense substantially. The expense of purchasing merchandise for resale and of carrying it in stock could be eliminated. The burden on the executives of the company could be lightened and, under the new plan, they could devote their entire energies to the production and sale of the company's own products.

March, 1926 M. T. C.

RANIER MANUFACTURING COMPANY[1]

MANUFACTURER—PUMPS

DISTRIBUTION CHANNELS—*Manufacturers' Agent as Alternative to Wholesalers in Development of New Territory.* The company contemplated seeking a market in New England for the industrial pumps which it manufactured at its plant in Seattle. It was deemed impractical to establish a wholesale sales branch in the territory; consequently, a problem arose as to whether to grant an exclusive agency for the territory to a firm of hardware wholesalers or to employ a manufacturers' agent.

(1919)

The Ranier Manufacturing Company, of Seattle, manufactured pumps to be attached to tanks or barrels for handling liquids, such as lubricating oils, gasoline, distillate, kerosene, turpentine, shellac, varnish, belting cement, vegetable oils, molasses, syrup, and flavoring extracts. The chief features of these pumps were: a patented drip pan, which collected all drip and overflow, straining and returning this to the container; speed in pumping heavy liquids; prevention of evaporation; and special facilities to assure ease of adjustment and operation.

Four hundred and fifty of these pumps had been installed by one railroad company. This railroad expended annually $700,000 for the purchase of lubricating oils. Prior to the installation of these pumps, the waste of oil through drippings had been figured at 5%. Most of this waste had been eliminated by the use of the pumps. The pump also had a market among retail merchants who sold oil and other liquids in bulk. Another market existed among farmers and shops that bought liquids in barrel lots.

The retail selling price of the pump was $20. To wholesalers it was sold for $12 and to retailers for $16.

The Ranier Manufacturing Company contemplated making arrangements for the sale of its pump in New England. Previously it had sold its output chiefly along the Pacific seaboard. The manufacturer would pay the freight charges to New England. It did not seem practical to establish a wholesale sales branch at such a distance from the factory.

[1] Fictitious name.

One means that was suggested for developing the market for this pump in New England was to grant an exclusive agency for the New England territory to a firm of hardware wholesalers in Boston. Another proposal was to arrange with a manufacturers' agent, who also represented several other manufacturers of related products, to sell the pump on commission to wholesale purchasers. It was expected that it would be necessary to pay such an agent 10% of his sales and to grant him a contract of several years' duration.

Commentary: After the company had decided not to establish a sales branch in the New England market, a manufacturers' agent was to be preferred to a wholesale hardware firm as territorial representative. A typical wholesale hardware firm would have provided distribution to hardware retailers and small shops, but its sales organization and methods would not have been effective in reaching railroads and other large industrial companies. A manufacturers' agent, with only a few lines to sell, could have utilized more persistent sales methods for this product than would have been consistent with the methods of a typical wholesale firm. The manufacturers' agent would take the place of a manufacturer's sales branch and could be expected to secure orders from railroad companies, large industrial companies, and supply wholesalers, and to utilize the services of several hardware wholesalers for reaching scattered retailers. Inasmuch as the product was of a type of accessory equipment for which it was not necessary for the manufacturer to provide engineering and designing service, supervision of installation, or repair service, a manufacturers' agent could have been utilized as a substitute for a manufacturer's sales branch in a distant territory.

February, 1926 M. T. C.

Lane Equipment Company[1]

MANUFACTURER—RAILROAD BRAKE LEVERS

Distribution Channels—*Manufacturers' Agent as Alternative to Direct Selling in Development of New Territory.* For negotiating the introductory sales of its make of railroad brake levers and lever connections in the New England market, the company apparently had to choose between the employment of a manufacturers' agent or the use of its own salesman.

(1919)

In 1918 the Lane Equipment Company decided to enter the eastern markets with its brake levers and lever connections for use on freight, passenger, and engine-tender equipment. Previously the company had sold its products chiefly in the Middle West. Compared with other brake levers on the market, the Lane brake lever was stated to be 50% stiffer and 30% lighter. The prices at which that brake lever was sold to railroads ranged from $1.50 to $2.10, according to size. The lever connections were sold for $2.05 each.

In New England the S. K. Thomas Company[1] was the principal distributor of railroad equipment. That company already carried a full line of railroad accessories and equipment, including levers and connections made by other manufacturers. Inasmuch as the S. K. Thomas Company did not believe that there could be many immediate sales of Lane equipment, it was not willing to undertake to introduce the new line.

The Lane Equipment Company could send one of its own salesmen into the territory to sell directly to the railroad companies, but the cost at the start would be approximately 50% of the selling price. Although the salesman would devote his entire time to introducing these products, it was realized that his lack of established relationships in the territory would handicap him. The company estimated that, under such a plan, sales in New England probably would be made at a loss for at least five or six years.

Another possibility was for the company to make a contract

[1] Fictitious name.

with A. S. Brown,[2] a manufacturers' agent. Although Mr. Brown never had sold brake levers, he was favorably impressed with the Lane Equipment Company's product and was willing to undertake to develop the market for it if granted an exclusive agency for New England for 10 years and a 10% commission on sales. The market for other railroad equipment sold by Mr. Brown was sufficiently developed to permit him to push the new line energetically.

Mr. Brown's method of securing orders for a new article was to convince the minor executives of a railroad company that he was offering a dependable type of equipment and then to lay his case before the president or other high official of the railroad company. He told the Lane Equipment Company that because of the amount of preliminary missionary work to be done, from three to four years might be required for the introduction of that company's levers and lever connections.

The Lane Equipment Company's problem, therefore, was whether to sign a 10-year contract with Mr. Brown to sell its brake levers and connections or to place one of its own salesmen in the New England territory.

Commentary: The particularly significant facts in this case are the following: The company was manufacturing and selling accessory equipment. The unit price of this equipment was not high. Individual orders were likely to be large. The number of potential purchasers was small. These purchasers could be expected to buy only at infrequent intervals. In introducing this equipment, furthermore, it would be necessary, ordinarily, to persuade the prospective customer to change his preference from some other type of equipment already in use to that which was offered by the Lane Equipment Company. The fact that it was necessary to effect this change in preference made the problem of the Lane Equipment Company different from that of a company introducing a type of equipment which would not displace or replace equipment already in use.

If the company had employed its own salesman for the New England district, the salesman would have concentrated his attention on securing orders for the company's product, whereas the manufacturers' agent had several lines over which to diversify his efforts. The advantage of concentrated attention from the company's salesman, however, would

[2] Fictitious name.

have been offset largely by the influence of the established relationships of the manufacturers' agent.

The influence of established relationships is of especial consequence in this case because of the small number of potential customers, each of whom might be expected eventually to purchase in large quantities. In order to induce potential customers to change their preference from a type of equipment already in use to the type offered by the Lane Equipment Company, a period of prolonged negotiations with the prospective customers would have been necessary. In carrying on such negotiations it obviously would have been poor sales strategy for a salesman to have called on prospective customers at frequent intervals. With only a single line to offer and a restricted number of potential customers, it is doubtful if the market would have been sufficient in magnitude to have kept a salesman busy in selling the single line. The manufacturers' agent, on the other hand, had several lines and a greater number of potential customers. The diversity of lines for which the manufacturers' agent was seeking orders, furthermore, would have made it possible for him to call frequently on prospective purchasers of such equipment as the Lane Equipment Company was making and thus have afforded opportunities for keeping the negotiations on Lane equipment active without intrusively forcing the question on prospective customers before they were disposed to decide on the purchase.

The period of introductory negotiations was expected to cover several years, whether those negotiations were handled by the company's salesman or by the manufacturers' agent. The 10-year contract demanded by the agent, therefore, was not unfairly long, either for the company or for the agent.

Under the circumstances, it appears that it would have been sounder policy for the company to have employed a manufacturers' agent rather than to have sent its salesman into this market. It is not clear, however, why New England was separated from the other eastern markets in this case, and the decision as regards the New England market might well have been governed by the policy adopted for New York, Pennsylvania, and other eastern districts.

The case serves chiefly to emphasize the necessity of providing for a period of negotiation in introducing a new make of accessory equipment which supplants a type already in use.

November, 1925 M. T. C.

Stetlow-Carroll Company[1]

MANUFACTURER—GRINDING MACHINES

Distribution Channels—*Establishment of Sales Branches as Alternative to Use of Manufacturers' Agent.* The company sold through manufacturers' agents the grinding machines which it manufactured. Since those agents also sold the products of numerous other manufacturers, their salesmen were not thoroughly familiar with the performance of the company's machines and occasionally erred in their recommendations to purchasers. Despite the disadvantages of breaking established relationships, the company decided to operate its own sales offices in the chief market centers in order to be able to exercise complete control over the sales methods used.

(1923)

The Stetlow-Carroll Company manufactured grinding machines in a wide variety of types, ranging in selling price from $1,500 to $15,000 each. The company listed its grinding machines with manufacturers' agents operating in districts where there was a general demand for machinery of this type. The sales agents sold for the Stetlow-Carroll Company's account and received commissions on their sales. In 1923 the sales manager of the company proposed that the policy should be changed, and that sales should be made directly to users of the machines by salesmen employed by the company. The sales manager had reached the conclusion that the sales agents were not securing an adequate proportion of the total orders placed for such equipment and were not fully developing the potential demand. He also was convinced that the reputation of the company suffered in some instances because the wrong type of machine was sold through incorrect recommendations to purchasers.

The company's machines were designed to grind all kinds of metal, rubber, glass, marble, and other materials. Sales were made principally to manufacturers of automobile parts, tools, and other metal articles.

The agents through whom the company was selling its machines did not handle competing products. In order to secure a satisfactory volume of sales, a sales agent usually sold about 30 lines

[1] Fictitious name.

of tools and accessories. The interests of an agent, therefore, were so divided that his salesmen were not thoroughly familiar with the Stetlow-Carroll Company's machines and with the operations for which the various machines could advantageously be utilized. Although the company maintained a small force of traveling demonstrators who assisted in selling the machines and in supervising their installation, it was possible for these demonstrators to reach only a relatively small number of the potential purchasers.

Inasmuch as a purchase of such installations required a large investment, each purchaser expected the machines to be efficient in operation. That result could not be assured unless the proper type of machine was recommended in accordance with each purchaser's requirements. The grinding machines embodied complicated mechanisms and required careful installation and well-trained mechanics to operate and maintain them. Each machine ordinarily could be adapted for several purposes by the addition of one or more special parts.

The sales manager recommended that, if the company ceased distributing through selling agents, one or more of its own salesmen should be placed in each important market for its machines in the United States. These markets included New York, Philadelphia, Detroit, Cleveland, Pittsburgh, and Boston. It was estimated that before he began to solicit orders each new salesman should spend from six months to a year in the factory in order to acquire familiarity with the construction and performance of each machine. Then one or more of these salesmen would be assigned to each of the company's sales offices, to be established in the large markets, to interview potential purchasers. When a prospective customer required recommendations regarding the type of machine to purchase, the salesman would be able to submit a dependable opinion, and after a sale had been made the salesman would supervise the installation of the machine. Thereafter, the company could maintain relationships with the user through the salesman, and complaints could be adjusted promptly.

The company decided that the expense of maintaining the suggested sales offices would be more than offset by the increased volume of sales to be secured by direct solicitation. It was

apprehended, furthermore, that under the existing plan much of the correspondence pertaining to complaints probably never reached the company from the selling agents.

Since the selling agents had made efforts over a period of years to build up clienteles to which they could sell grinding machines, the substitution of direct selling methods by the company was expected to create ill feeling, and might result in the company's representatives finding it difficult to approach customers who had had satisfactory business relations with the agents. On the other hand, there were instances in which the purchasers were dissatisfied because the agents had recommended the wrong machines and had failed to give sufficient supervision and instruction during their installation.

The direct sales plan would not alter appreciably the amount of credit granted by the company or the terms of sale. It was possible that with complete control of the solicitation of orders a small reduction might be made in the losses from bad debts.

Inasmuch as the company assembled and shipped machines only after orders were received, the district offices would not have to carry stocks of machines. They would carry stocks of repair parts, however.

The Stetlow-Carroll Company adopted the policy of establishing sales offices in all districts where there appeared to be a potential demand for its machines adequate to permit economical operation of the offices. A few selling agents were retained for securing orders in agricultural districts in the South and West, where the number of possible customers was small, and where the demand for grinding machines could not be increased substantially by direct sales efforts.

Commentary: The market for this company's products, as for many other installations, was well defined; it was not difficult to ascertain the identity of potential users of such machinery. The market also was largely concentrated in a few industrial districts. Each purchase was made for a definite purpose and required a substantial investment. In order to effect sales and to assure the degree of satisfaction among customers which was necessary for maintaining and enhancing the reputation of the company and its products, the specific requirements of each prospective purchaser needed careful study. After a machine had been installed, furthermore, it was desirable that its operation

should be observed by a representative of the company which had sold it, in order to make sure that its performance was satisfactory. These services, in studying specific requirements and in inspecting the machinery when installed, could be supervised more satisfactorily when the company employed salesmen directly on its own account than when the sales were entrusted to sales agents who also were selling numerous other products. In contrast with this situation is the case of the Ranier Manufacturing Company, which could be expected to make satisfactory use of manufacturers' agents; that company sold accessory equipment of low unit value for which it was not necessary for the seller to study the specific needs of the purchaser or to provide supervisory service.[2]

The Stetlow-Carroll Company apparently had attained a scale of operations large enough to warrant the adoption of a direct sales plan. The chief disadvantage in supplanting the sales agents by the company's own salesmen lay in the difficulties which would be encountered in establishing relationships expeditiously with prospective customers. Repeat sales of installations are made only at infrequent intervals, and the preparatory negotiations which precede each sale usually extend over a long period. The agents had negotiations under way, which it was by no means certain that the company's salesmen could pick up at the point where the agent's salesmen would drop them. A temporary curtailment of sales, therefore, was likely to be experienced.

This case emphasizes particularly the sales service needed for selling installations and the importance of the prolonged negotiations which usually precede each sale.

December, 1925 M. T. C.

[2] See page 32. See also Lane Equipment Company, page 34.

Copper Range Company

PRODUCER—COPPER

Distribution Channels—*Sales Department Utilized in Preference to Selling Agents.* The company, a producer of copper, discontinued its arrangement with a large selling agency which was controlled by another copper mining firm and which theretofore had marketed the company's output, as well as that of several other copper companies. The company decided to establish its own sales department, on the ground that closer contact with its market was desirable.

(1920)

In the latter part of 1920 the Copper Range Company, the second largest producer in the Lake Superior district, discontinued the arrangement whereby its output had been sold by the United Metals Selling Company and established its own sales department. At that time it was estimated that approximately 70% of the copper mined in the United States was sold through five selling agencies.[1]

Since from 90 to 105 days ordinarily elapsed from the time when copper ore was mined until the refined product was sold, the financing of copper-mining companies was an important part of a selling agency's function; it was stated that selling agencies in the copper trade had developed partly because financial firms were unwilling to advance money unless they could have control of sales. The usual commission paid to a selling agency was 1% of the selling price. Prices were quoted by the pound, and terms formerly had been 30 days net, cash on delivery ½ of 1% discount. After the World War, the cash discount was in many cases discontinued, and terms were quoted of 10 days from the date of the bill of lading or cash on arrival. Copper commonly was sold on a delivered basis, since it was granted refining-in-transit freight rates. Refineries, where stocks of finished copper were carried, for the most part were located near the eastern seaboard of the United States in order to be near the principal industrial purchasers of copper. Smelters, however, were situated near the mines.

[1] See Richter, F. Ernest, "The Organization of the Copper Market," *Harvard Business Review,* January, 1923, Vol. I, No. 2, pp. 196-211.

There were practically no merchants in the copper trade, with the exception of a few dealers in scrap metal. Since the market for copper was confined largely to a small number of well-known manufacturing companies, selling agencies sold directly to users. The principal users of copper were in the brass and electrical industries, in which a few large firms predominated.

The Copper Range Company was incorporated in 1899 in Michigan, and in 1920 had a capitalization of $10,000,000. Exhibit 1 shows the company's production from 1910 to 1921.

EXHIBIT 1*

PRODUCTION AND NET PROFIT OF COPPER RANGE COMPANY

Year	Ore (tons)	Copper (lb.)	Yield per T. Lb.	Price Received (cents)	Cost per Lb. (cents)	Net Profit
1921	....	30,000,000†	....	....	....	....
1920	452,957	16,951,105	37.42	17.14	17.17	$ 4,839‡
1919	614,342	23,082,498	37.57	18.67	15.35	972,654
1910-19	1,071,746	28,581,304	26.67	18.87	10.87	2,293,955

*Table taken from Walter Harvey Weed, *The Mines Handbook*, Vol. XV, p. 863.
†Estimated.
‡Deficit.

It was stated that in 1917 the Copper Range Company's output was sold for the highest average price ever received by any copper company; namely, 28.735 cents per pound.

The United Metals Selling Company, through which the Copper Range Company had sold its output until the latter part of October, 1920, was controlled by the Anaconda Copper Mining Company and sold copper for that company and seven other producers in addition to the Copper Range Company.

It was stated that the decision of the Copper Range Company to establish its own selling agency was made because of the company's desire for closer contact with its market than could be furnished by a selling agency which handled the output of several companies.

COMMENTARY: The decision of the Copper Range Company to establish its own sales department was not, in itself, a particularly significant event. It reflected a readjustment of sales plans during a period of severe depression by a company which had substantially strengthened its financial position during the preceding decade. The

fact that the selling agency which previously had sold the company's output was controlled by another large mining company may have influenced the decision. The Copper Range Company's relation to the selling agency, however, apparently had been no different in principle from the relations of numerous copper-mining companies to their selling agencies.[2] This case serves principally to record a few aspects of the relations between producers and selling agents in the copper industry, which probably are without parallel in other large industries.

October, 1925 M. T. C.

[2] See Richter, F. Ernest, "The Organization of the Copper Market," *Harvard Business Review*, January, 1923, Vol. I, No. 2, pp. 196-211.

Geyser Oil Refining Company[1]

MANUFACTURER, WHOLESALER, AND RETAILER—MOTOR OIL

Advertising—*Distinctive Color to Identify Product.* The company wished to insure identification of its motor oil by consumers, in order to avoid substitution by retailers and to make its consumer advertising effective. To aid in identification, the company could feature either a two-quart container which it recently had developed, or the distinctive color of its oil. The retail price was less for bulk oil than for oil in tins, and consumers appeared to prefer to buy oil in bulk. The company decided to stress the distinctive color of its oil rather than the merits of the two-quart container.

Distribution Channels—*Retail Distribution Influenced by Manufacturer's Emphasis on Bulk Rather than Package Sales—(Commentary).* Because consumers appeared to prefer to buy motor oil in bulk, the company, which manufactured motor oil, decided to feature the distinctive color of its oil in its advertising rather than to stress oil in tins. The company's decision not to emphasize tinned oil meant that instead of attempting to obtain as dense retail distribution as possible through hardware stores, accessory stores, garages, and filling stations, the company would depend chiefly upon selected filling stations and garages.

(1923)

During the first eight months of 1923, the Geyser Oil Refining Company's sales of motor oil in tins constituted but 6% of its total sales of motor oil. The advertising manager was of the opinion that the company should attempt to sell a larger proportion of its oil in tins. Larger sales of tinned oil, he maintained, would permit a closer tie-in between the company's advertising and its product, and would reduce the extent to which retailers substituted other oil for the company's oil. The sales manager, on the other hand, was convinced that many consumers were unwilling to pay the price differential between tinned oil and oil in bulk and that much of the effort that would be required to increase sales of tinned oil would be wasted.

The Geyser Oil Refining Company had begun to distribute high-grade gasoline and motor oil in 1911. The gasoline, under the trade name "Geyser," was sold in the eastern part of the United States only. In 1911, 95% of the company's motor oil,

[1] Fictitious name.

which was called "Lubrikol," was sold to dealers in bulk from tank wagons and in drums; 5% was put up in 5-gallon and 1-gallon tins. A drum was a metal container holding from 50 to 52 gallons; a half-drum contained 30 gallons, and a quarter-drum 15 gallons. Sales of Lubrikol in tins gradually increased, until, in 1917, they represented about 10% of the company's total sales of motor oil.

During the five years from 1918 to 1923 there was a large increase in the number of gasoline and oil filling stations operated by refining companies and distributing companies. At those stations the demand for motor oil in tins was comparatively small; automobile owners apparently preferred to purchase bulk oil to be poured immediately into the engines of their cars by the attendants at the stations rather than to buy oil in tins.

In 1923 the Geyser Oil Refining Company had 700 wholesale branches from which it delivered oil and gasoline. All those branches were in the eastern part of the United States, as the company's sales in the West and South were not sufficient to warrant the maintenance of wholesale branches there. In densely populated sections in the East the branches were situated at 30-mile intervals; in sections less densely populated they were farther apart.

The company's salesmen who operated from these branches sold oil and gasoline in bulk, and oil in drums and tins, to garages, filling stations, hardware stores, and automobile accessory stores. Sales to hardware stores and accessory stores represented less than 1% of the company's total sales of motor oils. In densely populated sections, a salesman called on each retail distributor once a week; elsewhere the period between salesmen's visits varied from two weeks to a month. Tank wagons were used in distributing bulk oil and gasoline to retailers located within reasonable distances from the branches. Retailers in localities remote from the branches purchased oil in drums. The company sometimes sold fractional drums of oil directly to large industrial users and to individuals for use in their garages. Such sales, however, amounted to less than 1% of the total sales of Lubrikol.

In the East the Geyser Oil Refining Company also owned and operated 100 retail filling stations. The company was adding new stations gradually, but the sales of its stations represented

only a small part of its total sales. Lubrikol, for instance, was sold by about 40,000 retailers in the United States. Approximately half as many retailers sold Geyser gasoline.

Although it sold no gasoline in the Middle West or South, the company maintained salesmen in those territories to sell Lubrikol in drums to retailers. Shipments were made directly from the company's refineries.

On the Pacific Coast, Lubrikol was distributed by three wholesalers who sold that brand of oil exclusively. Since those wholesalers were at liberty to select their own methods of distribution, changes in the sales policies of the Geyser Oil Refining Company were not assured of immediate or uniform adoption in that section of the United States. The three wholesalers advertised locally, and also secured the benefit of the Geyser Oil Refining Company's national advertising.

The Geyser Oil Refining Company had established a wholesale price differential between oil in tins and oil in bulk adequate to cover the additional packaging and distribution costs of the tinned oil. The wholesale list price per gallon for bulk oil was 55 cents; for oil in drums, 60 cents; for oil in 5-gallon tins, 71 cents; and for oil in 1-gallon tins, 75 cents. The company did not advertise retail prices, but suggested that the retailers observe the following prices: 25 cents per quart; 90 cents per single gallon; 85 cents per gallon for 5-gallon lots in bulk, whether purchased by the retailer in drums or from tank wagons; $5.10 for 5-gallon tins; and $1.30 for 1-gallon tins. Filling stations owned by the Geyser Oil Refining Company sold the products of that company only and adhered to the suggested retail prices for tinned oil. Other retailers, however, in numerous instances cut prices on oil in tins. Occasionally price-cutting became so serious that retailers were unable to sell tinned oil at a profit. The retail prices of the bulk oil, on the other hand, showed little variation.

The total sales of the company in 1922 had amounted to $180,000,000. The advertising appropriation was $1,500,000. This amount included expenditures for road signs, billboards, circulars, magazine advertisements, and for all other forms of publicity. Although the company sold other petroleum products, the emphasis of the advertising was on Geyser gasoline and Lubrikol.

In 1922 the chemists of the Geyser Oil Refining Company had developed a new type of motor oil, which happened to have a distinctive color. In order to take advantage of that feature, the company emphasized the color in advertisements and devised a road-side oil pump with a glass cylinder from which oil was drawn for customers. Through the use of that pump the company hoped to discourage substitution of inferior oil for Lubrikol and to permit identification of the product without the use of packages. The company had not installed the new pumps in its filling stations to replace existing equipment, but had leased new pumps to retailers who desired them.

In 1922 the company also had developed a new type of can which was easy to handle without soiling the hands. Cans of this type could be manufactured readily in a 2-quart size, which was expected to prove popular because of its handiness. In the summer of 1923, the company's salesmen made a special effort to stock garages, filling stations, hardware stores, automobile accessory stores, and other retail firms with the 2-quart tins. The price of the new 2-quart can of oil was 45 cents to retailers; the company suggested 65 cents as the resale price. The company allowed each retailer a maximum quantity discount of 10% on purchases of oil in tins if his total purchases of oil in that form during the year aggregated 750 gallons. On oil in bulk or in drums, total purchases of 1,250 gallons were necessary to secure this discount.

In an effort to develop demand for the new 2-quart can, the company's magazine advertising in the summer of 1923 stressed the convenience of that container. Sales of tinned oil, however, for July and August did not increase over the total for the same months in 1922, although sales of bulk oil increased 60%. Tinned oil constituted about 6% of the total sales of Lubrikol during the first 8 months of 1923.

The advertising manager favored the sale of a greater portion of the output of Lubrikol in tins. He deemed it necessary to market as much oil as possible in this way in order to prevent substitution and to afford a close tie-in between the advertising and the product. He was of the opinion that many retailers made a practice of putting into their own tanks or drums oil on which

their gross margin was larger than on advertised brands and selling that oil for whatever brand was requested.

A competitor of the Geyser Oil Refining Company, the Eureka Oil Company,[2] produced Parex Motor Oil. Since that company did not sell gasoline, it was unable economically to operate wholesale branches and tank wagons except in New York City. That company had advertised extensively over a period of years, with emphasis on tinned oil. As a result, in 1922 its sales of motor oil in tins were estimated to be about half the total sales of oil in that form in the United States. The Eureka Oil Company also sold a large volume in bulk, which, except in metropolitan New York, was distributed to retailers in drums. On Parex oil in drums the retailers' gross margin was slightly less than on Lubrikol purchased from tank wagons. So strong, however, was the demand from consumers for Parex Motor Oil that many filling stations stocked it as an additional brand.

The sales manager of the Geyser Oil Refining Company considered it inadvisable to attempt to increase the proportion of oil sold in tins. He held the opinion that consumer resistance to its purchase in this form was strong because bulk oil could be obtained more conveniently and more cheaply from filling stations, and because free crank case service was increasing. Because of the cost of the containers, retailers ordinarily were not called upon to fill crank cases with oil from tins. The sales manager believed a large majority of motorists never demanded a particular brand. He expected waste effort, consequently, if oil in tins was stressed in the company's advertising. To discourage substitution, and to create consumer preference, he believed Lubrikol should be advertised with emphasis on its distinctive color.

The company decided to feature the distinctive color of its oil.

COMMENTARY: The primary question in this case was whether to feature the new 2-quart can or the color of the oil in an attempt to stimulate sales. The industry was afflicted with the abuse of substitution of one brand of oil for another without the knowledge and consent of consumers. Hence, unmistakable identification of the company's product when bought by consumers was a major objective.

[2] Fictitious name.

This identification was essential to render effective the special buying motives for the company's oil.

Both the 2-quart can, which bore the company's trade-mark, and the distinctive color of the oil afforded means whereby the company's brand could be identified by consumers at the time of purchase. The visible pump aided in identification, but the oil sold in bulk could be identified by its color whether or not the visible pump was used. Hence either plan of procedure could be expected to check substitution and to enable the company to stress the dependability of the quality of its product and other special characteristics. The prices at which the product was sold in cans and in bulk apparently were adjusted to compensate for differences in costs. Hence, neither method was to be preferred by the refining company solely from the cost standpoint.

The company's initial effort to increase sales of tinned oil by stressing the 2-quart container in its advertising had not been measurably productive. The 2-quart container was handy to use, but consumers apparently preferred to leave the task of putting oil into their cars to the attendants at filling stations and garages. Since the bulk oil was cheaper than the tinned oil, purchasers at filling stations and garages usually did not call for tinned oil. The color of Lubrikol sold in bulk furnished means of identification and consequently of protection to consumers on quality. That offset one of the advantages of the tinned package. The other advantages of the tinned package were more than counterbalanced by the strength of the motives for buying oil in bulk: the avoidance of unpleasant tasks, and economy in purchase.

The company, to be sure, could have realized some advantage, in its effort to obtain the full benefit from the consumer preference which its advertising created for Lubrikol, by securing dense retail distribution; and, if the company had decided to feature its 2-quart can, dense distribution for its product, not only in filling stations and garages but also in a large number of retail hardware stores and automobile accessory stores, would have been essential.

In selling its oil in bulk, however, the company's task was to induce consumers to patronize a series of carefully selected garages and filling stations, or its own filling stations, for the purchase of Lubrikol. Although the company would continue to accept orders for oil in tins, its decision to emphasize the color of the oil as a means of identification meant that its chief objective was to stimulate the purchase of oil in bulk by consumers from a series of selected garages and filling stations. The company thereby sought to cater to the strongest buying motives, beyond dependability in quality, which influenced consumers in the purchase of oil.

March, 1926 M. T. C.

Mersey Appliance Company[1]

MANUFACTURER—ELECTRICAL APPLIANCES

Distribution Channels—*Exclusive Agencies as Alternative to Dense Distribution.* It was suggested that the company should sell the electrical appliances which it manufactured through a series of selected wholesalers with exclusive agencies instead of through all available distributive outlets, both wholesale and retail, as it was doing. The general manager of the company, however, was convinced that the company should obtain as dense retail distribution as possible, and, hence, was opposed to limiting distribution to selected wholesalers.

Pricing—*Use of Varying Scale of Trade Discounts—(Commentary).* The company, a manufacturer of electrical appliances, offered trade discounts which varied not only as between types of distributors—wholesalers, electric light and power companies, and other retailers—but also with the sales effort exerted by the distributors and with the size of their purchases. If the company had adopted a carefully formulated policy of retail distribution, as was suggested, it should have followed a one-price policy, varying price only on the basis of the quantity of appliances purchased. The preferential discounts would have been inadvisable.

(1923)

Because its sales were not increasing so rapidly as were those of its competitors, the Mersey Appliance Company in 1923 contemplated changing the distribution policies that it was following in selling electrical household appliances throughout the United States. The general question at issue was whether the company should continue to sell its products through all available distributors or through a series of selected distributors.

The company manufactured, for household use, flatirons, radiator heaters, heating pads, breakfast stoves, ranges, toasters, and soldering irons. The soldering irons were used also in machine shops. In addition, the company manufactured electric heating elements for a firm manufacturing electric irons.

The company maintained offices and warehouses in Boston, New York, and Chicago. Salesmen from the Boston office solicited orders in New England. The other Atlantic Coast and Gulf states constituted the territory of the New York office. The

[1] Fictitious name.

remainder of the United States was the territory of the Chicago office. Four or five salesmen commonly traveled from each of the three offices. The company occasionally received orders through the mails. Most of the sales of Mersey appliances were made in the New England states and in the metropolitan districts of New York, Philadelphia, and Chicago. The orders secured from other districts of the United States were widely scattered; comparatively few sales were made in the Rocky Mountain district.

The company sold approximately 80% of its output to wholesalers, 15% to retailers, 4% to manufacturers, and 1% directly to consumers. The customers included wholesalers of electrical goods, hardware wholesalers, electric light and power companies selling appliances at retail, contractor-dealers who sold electrical appliances and supplies, a few specialized retailers of electrical goods, department stores, drug stores, house-furnishing stores, hardware stores, and a few general merchandise stores. In several territories, in order to assist wholesalers, the company's salesmen obtained orders from retailers and turned the orders over to the wholesalers to be filled. The company occasionally sold directly to retailers in territories where it did not receive adequate patronage from wholesalers.

Among the retail distributors, the central stations of electric light and power companies, in theory at least, offered special advantages. Those stations were directly in contact with the potential retail market for electrical merchandise; each family that used electricity was a potential purchaser of electrical appliances. However, although the use of those appliances helped to increase the sales of electricity, many central stations did not operate stores in central locations or use aggressive methods in advertising and selling appliances.

Contractor-dealers, like the electric light and power companies, were engaged exclusively in the electrical industry. An electrical contractor executed contracts for the wiring of buildings and performed repair work on motors and electrical appliances; he became a contractor-dealer when he opened a store for the sale of wiring supplies and other electrical goods. In the United States there was a large number of contractor-dealers, and their credit ratings and merchandising efficiency varied widely. A large

majority had small sales and were interested in their stores chiefly because of the discounts allowed dealers. Some contractor-dealers, however, had well-kept stores and used aggressive merchandising methods.

The Mersey Appliance Company offered trade discounts graduated on a quantity basis. For wholesalers that made particular efforts to sell Mersey appliances the maximum discount was 48% from the retail list prices; the usual maximum discount for other wholesalers was 47%. A few light and power companies that purchased large quantities of appliances for sale at retail secured a 48% discount, but the Mersey Appliance Company ordinarily offered a discount of only 38% to central stations buying directly. The maximum discount for all other types of retail distributors was 35% from the retail list prices.

The trade discounts allowed on individual orders were graduated according to whether the order was for a broken package of less than 6 appliances, for a standard package of more than 6 and less than 24, or for a standard shipment of 24 appliances. For example, a central station received discounts of 30%, 35%, and 38%, respectively, on the three types of orders mentioned. This policy of graduated discounts had been adopted because of the higher proportionate expense incurred in filling small orders. No other quantity discounts were offered. The company urged its wholesale distributors to offer retailers discounts similarly graduated. The wholesalers, however, did not adhere strictly to this plan.

In many instances, the company allowed a wholesaler part of the profit obtained on sales made directly to retailers in that wholesaler's territory. Such concessions, however, were not made in accordance with any definite policy. The company was experiencing difficulty in obtaining satisfactory wholesale distribution. Consumer demand apparently was not sufficiently strong in all sections of the United States to make wholesalers willing to stock Mersey appliances.

The company's discount policy had resulted in frequent disputes. Central stations which were entitled to only a 38% discount from the retail list prices often tried to secure a 48% discount; and contractor-dealers who were allowed only a 35% discount occasionally demanded the discount received by whole-

salers. The company, moreover, had been unable to maintain standard resale prices. Central stations frequently sold appliances at reduced prices in order to encourage use of electric current.

It had been suggested at one time that the Mersey Appliance Company, in order to avoid trade disputes and to secure closer supervision of sales, should undertake to sell its products directly to selected retailers of electrical goods throughout the United States. The company had not given this plan favorable consideration, however, because it had been the policy of competing manufacturers to sell through practically all available retail outlets.

Selling costs for the Mersey Appliance Company ordinarily were from 22% to 23% of net sales. The net sales amounted to slightly more than $1,000,000 in 1922. Normally the company spent a sum amounting to approximately 7½% of net sales for advertising, principally in newspapers in the large cities. The company also sent circulars directly to potential customers whose names were submitted by retailers and distributed material to retailers for use in local circularizing campaigns. The sales manager estimated that the company's strongest competitors expended on advertising about 10% of their annual net sales.

The general manager of the company was convinced that the appropriation for advertising should be increased sufficiently to create consumer preference for the company's products, and that the company should continue to sell through all available distributive outlets. Increased consumer demand, he stated, could be expected to cause distributors to support actively the sale of the company's appliances, and, thus, wide distribution could be effected.

Other officers, however, held that it would be a sounder policy to distribute the appliances through selected wholesalers of electrical goods with exclusive territorial rights. Supporters of this plan maintained that wholesalers had not sought actively to build a market for Mersey appliances, because they had not been protected from the competition of other distributors. Exclusive territorial rights, then, in conjunction with the expenditure of a nominal amount for national advertising, were expected to attract the cooperation of suitable wholesalers.

The general manager was of the opinion, however, that if exclusive representation were given to selected wholesalers the distribution of the products would be restricted; if electrical appliances were not available for purchase at as many places as possible, sales would be reduced. If a widespread consumer demand for Mersey products could be created by publicity, it appeared inadvisable to the general manager to limit the distribution to selected wholesalers.

COMMENTARY: The major problem in this case was the determination of the type of retail distribution best suited to this company's products. The company was aiming to have its goods available for purchase by consumers in as many retail stores as possible. The theory back of that practice, whether or not it was consciously realized, was that consumers preferred to buy electrical appliances at immediately accessible stores, as they bought cheese and crackers. No evidence was cited to support that practice by this company except the fact that competitors were using similar marketing tactics.

The alternative policy was to have Mersey appliances offered for sale in retail stores which attracted patronage by the variety of merchandise of this class which they offered and from which consumers could make selections, by the service which they furnished to customers on merchandise purchased at their stores, or by the aggressive promotion of the sales of a particular brand.

The unit price of electrical appliances was high enough to warrant consumers' putting forth effort to visit stores beyond the neighborhood radius. The articles were durable and long intervals would intervene between repeat purchases by individual consumers. The annual per capita sales of such appliances in any one neighborhood, therefore, were small as compared with groceries, for example, and hence the aggregate volume of sales of appliances was not sufficient to enable numerous retailers in a small community to gain a livelihood by selling appliances only. The practice which the company was following must have resulted in its merchandise being carried in stock by many contractor-dealers and other retailers who accepted that merchandise casually as a side line, on which little sales effort was to be expended.

In my opinion, the company would have accomplished better results by adopting the alternative policy of selecting, for the sale of Mersey appliances, retail stores which were specializing in the sale of such goods and which were utilizing forceful merchandising methods. The decision as to whether to sell to contractor-dealers, public service companies, department stores, or other retailers would have been made

in each individual case on the merits of the merchandising service that the retail institution offered. The company's advertising probably could have been made fully as effective in directing consumers to the stores of selected merchants as in leading them to expect to be able to pick up such merchandise at the nearest corner store.

To carry out a policy of selected retail distribution it would have been necessary to grant exclusive agencies to wholesalers[2] or to have sold directly to the retailers.

If a carefully formulated policy of retail distribution had been adopted by the company, it should have been accompanied by a one-price policy, whereby the only variations in price were for different-size packages. The special concessions to favored customers constituted a violation of a one-price policy.

March, 1926 M. T. C.

[2] See Devon Phonograph Company, 1 H.B.R. 303; commentary, 2 H.B.R. 484.

Touraine Company[1]

MANUFACTURER—FURNITURE

Distribution Channels—*Use of Exhibitions in Furniture Trade.* For the furniture which it manufactured the company secured orders at the semiannual "markets" or exhibitions held at Grand Rapids and also by employing traveling salesmen to call upon retailers. The company had simplified its line and was advertising its product in several magazines of national circulation. Each retailer selling Touraine furniture was furnished with an elaborate portfolio illustrating the complete line. The company's problem, in formulating a general sales plan for the future, was whether it should aim to sell the major portion of its output at the semiannual markets or by the employment of salesmen, portfolios, and advertising.

Merchandising—*Advertising as Aid in Simplifying Line—(Commentary).* The company manufactured and sold directly to retailers high-grade furniture, chiefly under its own brand. The company had begun to advertise that brand to consumers. This advertising would aid the company in its effort to simplify its line, since the advertising would enable the company to exercise control over the patronage of the consumers and, hence, to focus demand on relatively few patterns.

Brand Development—*Exclusive Agencies to Protect Retailers.* The company manufactured and sold directly to retailers high-grade furniture, chiefly under its own nationally advertised brand. The company had granted a few exclusive retail agencies, but protected most of its retail customers by not selling duplicate suites to different retailers in the same city. In view of the national advertising of its brand, the company contemplated giving all its retailers exclusive brand protection instead of exclusive pattern protection.

(1922)

The Touraine Company, of Grand Rapids, Michigan, which manufactured furniture of distinctive quality, in seeking to simplify its line began to advertise its products to consumers. This gave rise to new problems of the company's relation to retailers and the extent to which the company should depend for its sales upon the semiannual furniture exhibitions at Grand Rapids.

Furniture exhibitions, or, as they were known in the trade, "markets," were held twice each year, usually in January and June, at Grand Rapids, Michigan. At those markets, which were

[1] Fictitious name.

attended by 2,500 to 3,000 buyers, most of whom represented retail stores, samples were exhibited by 400 to 500 manufacturers of furniture and other house-furnishing goods with plants outside of Grand Rapids; in addition, about 40 local furniture manufacturers had their own showrooms at their plants. For the convenience of the outside manufacturers, there were seven large buildings primarily used for the exhibition of furniture at the semiannual markets. Markets, which lasted three weeks, were instrumental in indicating the designs that would prove popular and in establishing market prices. Manufacturers who exhibited at Grand Rapids ordinarily did not find it necessary to maintain elaborate sample rooms at their plants. It was stated that retailers commonly ordered from 40% to 50% of their requirements for the ensuing 6 months' period at the semiannual markets.

In June, 1922, the average value of samples shown by out-of-town manufacturers was estimated at $3,000 per manufacturer. The expense of exhibiting furniture at Grand Rapids was not inconsiderable. A representative firm in 1922, for instance, was using 6,000 square feet of space at an annual rental of 50 cents per square foot. In addition to rentals, a manufacturer exhibiting at Grand Rapids incurred heavy expenses for freight and for time and expenses of his salesmen, all of whom ordinarily attended those markets. Space in the exhibition buildings was said to aggregate 2,000,000 square feet, not including local factory exhibition space.

The semiannual markets at Grand Rapids had been an important feature of the furniture trade since about 1900. The association of local manufacturers which had been interested in developing the markets had turned its attention in recent years to the possibility of inducing manufacturers of lamps, rugs, carpets, stoves, kitchen cabinets, refrigerators, and other house furnishings to exhibit their products. Manufacturers of office furniture and equipment did not exhibit at Grand Rapids, since in most cases they had not found furniture retailers desirable outlets for their goods.

The furniture industry had tended to become specialized into the following divisions: (1) bedroom and dining-room furniture, known in the trade as "case goods"; (2) upholstered furniture; (3) chairs. Although some manufacturers made a general line

of furniture including all three of those divisions, in high-price furniture specialization was more common. Mirror manufacturing was an entirely separate branch, as were the iron and brass bed business and the office and school equipment business.

The supremacy of Grand Rapids in the furniture trade was due to the quality of the local products rather than to the quantity. Much of the best furniture made in the United States was produced in that region. That city had acquired advantages in the way of skilled labor, competent designers, and banks which were familiar with the furniture trade. Other furniture manufacturing centers in the United States were Jamestown, New York; Chicago, Illinois; Rockford, Illinois; and High Point, North Carolina. In several of those cities furniture exhibits were held, confined for the most part to local manufacturers. Competition was keen in the industry. Labor was the principal item of cost; raw materials constituted a small percentage of the cost of the finished product and the required mechanical equipment was not elaborate. Hence, it was comparatively easy for new firms to enter the industry and intensify competition.

Style in furniture was almost entirely a matter of period. Designers went back to well-known types, such as early American Colonial, Queen Anne, Sheraton, and Chippendale, as starting points in bringing out new designs. In this respect practically all modern high-grade furniture consisted of reproductions. Although any one period might be more popular than another for several years, most manufacturers made furniture of all the well-known periods and did not specialize on any one exclusively. Style changes in furniture were commonly not rapid enough to cause depreciation in the value of goods manufactured for stock.

In order to lower its investment in finished stock and to reduce the expense of getting out new samples twice a year for the Grand Rapids semiannual exhibitions, the Touraine Company from 1918 to 1922 had cut down its line from 60 dining-room suites to 40, and from 50 bedroom suites to 35. Partly because of this simplification of the line, the permanent display space, used throughout the year, was reduced from five floors to two. The Touraine Company's line, however, was still larger than that of many other high-grade manufacturers.

One of the important features of high-grade furniture manu-

facturing was the length of time necessary to turn out the finished product. Many of the suites of bedroom and dining-room furniture made by the Touraine Company, for instance, required from five to seven months from the time the lumber was taken from the dry kiln to the time when the furniture was ready for sale. Owing to the length of time required for manufacture, it was usually necessary to make up high-grade furniture for stock. Makers of medium- and low-grade furniture, the manufacturing of which was a much shorter process, were able to manufacture to order, at least in part, and thus to avoid the expense of carrying large finished stocks. Companies producing medium- and low-grade furniture also cut a much smaller number of different-patterned suites than did manufacturers of the more expensive products, thus securing the advantages of mass production.

Although occasionally makers of expensive furniture found it profitable to cut as few as five suites of one design, it commonly was necessary to make a larger number in order to have the operation show a profit. Since samples were made up in advance of the semiannual furniture markets, such firms as the Touraine Company found it necessary to begin manufacturing before they knew definitely what samples would prove popular at the coming exhibition. It was customary in such cases to carry the goods "in the white" and to finish them later according to the specifications of the buyers. Nevertheless, samples which did not prove popular constituted an expense that had to be absorbed in the general overhead. Toward the end of a season the Touraine Company frequently made up medium-grade furniture on a quantity production basis to be sold at substantially lower prices than its regular output.

Like other Grand Rapids furniture manufacturers, the Touraine Company made sales directly to retailers. Wholesalers were not numerous in the furniture trade except in some parts of the West. Where wholesalers were operating they commonly handled medium- and low-grade furniture. Chair factories often disposed of their output through wholesalers. Where wholesalers carried stocks, it was stated that they required a gross margin of 33⅓% on sales. Whenever goods were billed through them, but not carried in stock, a much smaller margin was sufficient. In several cities a difficult problem was presented by combination

wholesale and retail furniture firms, which frequently sold on an instalment basis. Furniture manufacturers usually did not maintain branch warehouses or offices, with the exception of showrooms in one or two large cities. It was estimated that there were between 15,000 and 16,000 furniture retailers in the United States. Although adequate data were lacking on expenses and the rate of stock-turn in the retail furniture business, there were reliable indications that expenses were high and the rate of stock-turn low.

The Touraine Company had seven salesmen with exclusive territories, five of them east of Chicago. Because of the relatively high retail prices of Touraine products, it had been the experience of the Touraine Company that it was not worth while to have salesmen call on retailers in cities with less than 20,000 inhabitants. Manufacturers of cheaper furniture, of course, required a larger number of salesmen, since they sold to retailers in small cities and towns.

The Touraine Company paid some of its salesmen on a straight-salary basis, others on a straight-commission basis, and some on a combined salary-commission plan. Men selling furniture, especially the more expensive lines, practically were in business for themselves so far as control by the factory was concerned. Two of the Touraine Company's salesmen, for instance, sold on salary for the Touraine Company and at the same time sold on commission for a manufacturer of medium-grade furniture in Grand Rapids.

It was not at all uncommon in the furniture business for salesmen to represent more than one firm, although, of course, the same salesman did not sell for competing manufacturers. A salesman who sold for several manufacturers in the furniture business sometimes was called a commission broker. Such commission brokers frequently had their own offices and employed salesmen either on salary or on commission to work directly for them; in some instances three or four salesmen selling on commission for different companies invested capital in a sales office and exhibition room at a centrally located point in their territory. One firm, for example, sold for six furniture manufacturers in New York City and New York State as far west as, but not including, Buffalo. That firm employed four salesmen, selling on salary and

commission. Of course, the exclusive territories of the six manufacturers did not exactly coincide; therefore, there were some towns in which that firm could not sell the products of all the manufacturers that it represented. Furniture salesmen and commission brokers usually received commissions on all orders shipped to their territories, whether or not they were instrumental in making the sales. It was stated that 10% was a common figure for the commission on upholstered goods, 5% to 7% on "case goods," and 5% on chairs.

Customers of the Touraine Company usually bought approximately half their season's requirements at the Grand Rapids market. Before the next market occurred, a retailer ordinarily was called on only once or twice by a salesman from the Touraine Company.

Although many furniture manufacturers quoted net prices to retailers, the Touraine Company quoted list prices subject to a single trade discount, ordinarily 40%. Terms were f.o.b. Grand Rapids, 2% for cash in 10 days, net 60 days. No attempt was made to maintain resale prices. It was stated that retailers handling Touraine furniture in small cities not uncommonly sold below the list prices, although many larger retailers, especially those who incurred high freight rates by reason of their distance from Grand Rapids, were obliged to set retail prices that were higher than the list figures. In several territories the Touraine Company had granted exclusive agencies to retailers. In others it had not done so, but following the common practice among high-grade furniture manufacturers, it did not sell duplicate suites to different furniture retailers in a single city. It was a frequently discussed problem among the executives of the Touraine Company whether the company should discontinue entirely the policy of granting exclusive agencies or adhere consistently to that policy in all territories.

The brand of the Touraine Company was placed in an inconspicuous position on all its furniture, with the exception of that sold to one or two large eastern specialty furniture stores which insisted on using their private brands. On the great bulk of the furniture manufactured in the United States, neither manufacturers' nor retailers' brands were placed.

In its policy of national consumer advertising, the Touraine

Company also had departed from the beaten track of furniture selling. In addition to such mediums as the *Ladies' Home Journal, Good Housekeeping,* and *House Beautiful,* the Touraine Company used class publications such as *Vanity Fair* and *Vogue.* Prior to the beginning of the business depression in 1920, the firm's advertising was of a general institutional nature. In 1921-1922, however, the policy was adopted of featuring a single suite of either dining-room or bedroom furniture each month, and retailers were urged to tie up with those advertising efforts by displaying the featured suite at the same time.

Since the change in advertising policy, the company had received numerous inquiries from consumers. All such inquiries it had turned over to retailers in the localities where the inquiries originated. Each retailer selling Touraine furniture was supplied by the company with an elaborate portfolio illustrating the complete line. Since about 15% of the suites were discontinued and a like number added during each six months' period, those portfolios were returned to the factory periodically in order that they might be brought up to date. Because the preparation and maintenance of the portfolios was expensive, retailers were charged $50 each for them. That sum, however, was rebated when the retailer's sales of Touraine furniture reached a specified volume.

Commentary: The starting point for an analysis of this case is the statement that the company had followed the practice of other manufacturers of good quality furniture by not selling duplicate suites to different retailers located within a single city. Brands had been of little consequence in the furniture business. Price-cutting and wasteful duplications of stocks of identical merchandise had been avoided by means of the exclusive suites sold to each retailer.

For a manufacturing company such as the Touraine Company prior to the inauguration of its advertising program, the control of distribution was largely in the hands of the retailers. Each retailer decided what suites to buy and from whom to buy without necessarily maintaining continuous relationships with a particular manufacturing company. The semiannual markets afforded convenient opportunities for the manufacturers to display their designs and prices in competition so that the buyers could make their selections. The buyers secured protection on resale by means of the rights to exclusive suites. If a buyer selected popular suites, he received the credit and many of the benefits

of the popularity; if his selections were unpopular, he bore the burden of that unpopularity.

The custom of allowing exclusive rights for the sale of a suite of a particular pattern in a city made it necessary to have enough variety to afford protection to numerous retailers. The system of selling at the markets, furthermore, was conducive to a multiplication of patterns, since the more patterns a manufacturing company could show the better chance it had of striking the fancy of the visiting buyers. It was the resultant variety of styles and patterns with which the Touraine Company was trying to cope when it undertook a program of simplification.

The advertising plans adopted by the Touraine Company and the emphasis on the Touraine brand were essential features of the program of simplification. At the same time the company was instigating far-reaching changes in its merchandising methods.

The advertising was directed at consumers. Consumers, if influenced by the advertising, would identify the company's product by its brand. The effect would be to enable the manufacturer to exercise some control over the patronage of the consumers. As the brand became stronger, the demand could be focused on relatively few patterns, changed from time to time as market conditions and consumers' preferences dictated. At the same time, it was essential that the company should continue to offer a sufficient variety of styles to guard against loss of sales to consumers who were seeking distinctiveness.[2]

Because of the high unit price of this class of furniture and the furniture's distinctive qualities, it was not to be expected that competing retailers would wish to carry duplicate stocks. The Touraine Company's advertising tended to make the company's brand a common tie for all the suites to which the brand was affixed. The use of the portfolios strengthened that tie. Hence, the brand was coming to stand for the company's full line, and it was not to be expected that competing retailers would be any more willing to duplicate brands than they were to duplicate patterns; in this instance, with the use of the portfolios, duplication of the brand in competing stores would have had many of the disadvantages of duplication of patterns.

The conclusion that the company should have granted exclusive agencies to retailers for the sale of furniture bearing its brand is unescapable. Such an arrangement, furthermore, would have strengthened the advertising plan by providing for continuous relationships between the retailers and the manufacturing company. The use of aggressive sales methods, as, for example, the coordinating of window

[2] An example of an even more exclusive type of demand is afforded by the Bigelow Furniture Company case, page 141.

displays and local advertising with the company's magazine advertising, was essential for the full enjoyment of the effects of the company's advertising; the sort of cooperation required could be looked for only under exclusive agency terms. One effect of the company's policy, therefore, was to substitute exclusive brand protection for exclusive pattern protection.

As rapidly as the company established strong, continuous relationships with retailers by granting exclusive agencies, the Grand Rapids markets were likely to dwindle in importance in that company's sales plans. Other furniture manufacturing companies, catering to different buying motives, would continue to find the semiannual markets of as great service as before, in bringing together buyers from retail stores and in affording a keen stimulus to the manufacturers' designers, but the Touraine Company was developing a type of business different from that of many other furniture manufacturers. The company's policy was effecting economies in production by simplifying the line; it was establishing a reputation for the company's brand among consumers; and it promised a change from dependence on the semiannual markets to continuous relationships with selected retailers.

March, 1926 M. T. C.

Vadner Department Store[1]

DEPARTMENT STORE—MEN'S CLOTHING

MERCHANDISING—*Discontinuance of Unprofitable Department.* Because the men's clothing department in its store had operated at a loss for several years, the company contemplated discontinuing it. The merchandise manager, however, was of the opinion that the department should be retained because it created good-will for the company and served to make the store complete.

(1925)

For several years the men's clothing department of the Vadner Department Store had shown a net loss from operations. Since the merchandise sold in that department was not related directly to the merchandise in which a majority of the sales of the store were made, the merchandise executives and the officers of the company, in January, 1925, discussed the advisability of discontinuing the department.

The Vadner Department Store was located on the main shopping street of a commercial city in the Middle West in the district between the exclusive shops and the popular-price stores. In addition to men's, women's, and children's wearing apparel, the store sold piece goods, furniture, house furnishings, and notions. It was estimated that most of the sales were made to families with annual incomes ranging from $2,500 to $10,000. The annual net sales of the store were about $12,000,000. The sales for 1924 showed an increase of 0.1% over those for 1923. The store delivered about 75% of the merchandise which it sold.

The men's clothing department of the Vadner Department Store was located in a well-lighted section on the second floor of a building next to the main store. There was an entrance to this section from the second floor of the main store. Elevator service made it possible for customers to enter the men's clothing department without passing through the main store. Men's hats and shoes also were sold in this location, but men's furnishings were sold on the street floor of the main store.

The men's clothing department sold business suits in dark and

[1] Fictitious name.

the more popular light shades, four-piece sports suits, dress suits and tuxedos, palm beach suits, flannel trousers, extra pairs of trousers to match the suits, dress vests, overcoats, raincoats, and topcoats. The range of the retail prices of the suits was from $35 to $65; of the overcoats from $35 to $115; and of the topcoats from $30 to $75. In each of these three types of merchandise the most popular selling prices were from $45 to $50. Sales of trousers, vests, and raincoats decreased the amount of the average sales check in the department to $32. The store did not use private brands on its men's clothing.

Total net sales in the men's clothing department for the year 1924 were $410,000. The maintained mark-up in that year was 22.4% of net sales. The net sales in the department for the fall season of 1924 amounted to $195,000. During that period, markdowns were 11.4% of net sales.

The direct expenses of the department, including advertising and salaries of salespeople, stock keepers, and buyers, were 13.4% of the department's net sales. The indirect expenses charged to this department, including rent, heat, light, outside delivery, and general overhead expenses, amounted to 17.2% of its net sales. Thus there resulted an operating loss of 8.2% of net sales for the year 1924. The policy of the Vadner Department Store was to load its merchandise in all departments with a required discount of 6% of the billed price of purchases. The usual annual rate of stock-turn in the department was 6 times. The rate of stock-turn obtained in the department during the fall season of 1924 was 2.7 times, as compared with 3.1 times for the whole store.

Clearance sales were held in the men's clothing department in July and January. At those times, all suits, overcoats, and topcoats in the department were marked at one price, $35. For the clearance sales a large quantity of new merchandise was purchased and offered in addition to the stock already accumulated in the department. A mark-up of approximately 37% of net sales ordinarily was placed on merchandise purchased especially for the sales. The result of offering different grades of merchandise at one price was that customers purchased the higher-quality merchandise and left that of lower quality. These special sales had been held for several seasons, and gradually a large quantity of low-grade merchandise had accumulated in the department.

During the two weeks' sale in January, 1925, $39,000 worth of the regular stock of the department and $45,000 worth of the specially purchased merchandise was sold. The stock on hand in the men's clothing department after that sale had cost $40,500 and was valued on the company's books at $60,000 at retail prices. The assistant merchandise manager estimated that the stock could be sold at retail for not more than $30,000.

The merchandise manager of the Vadner Department Store regarded the men's clothing department as to some extent a service department which created good-will for the store. He wished to retain the department because competing stores sold men's clothing and because, in his opinion, the store would be incomplete without it. By operating this department in addition to the men's hats, shoes, and furnishings departments, the company made it possible for a man to purchase his complete outfit in the store. Moreover, women, who were the principal purchasers in the other departments in the store, frequently inspected and sometimes bought suits and overcoats for their husbands. The merchandise manager believed that the men's clothing department was in the best location available for it in the store. Although he had no definite information on the subject, he was under the impression that several of the men's clothing departments operated by the other department stores in the city also showed losses.

The merchandise manager had tried several methods of sales promotion in the men's clothing department in an attempt to increase its volume of sales. Although the amount of the net loss in the department had decreased, there were no indications that the department could be made to yield a normal profit in the near future. One of the assistant merchandise managers suggested that perhaps the chief reason for the unprofitableness of the men's clothing department was that a department store was essentially a store for women and that men consequently preferred not to buy there.

There was not sufficient space in the area allotted to men's clothing for the inclusion of men's furnishings. Even if there had been, however, the merchandise manager would have been unwilling to move the men's furnishings department, since it was operating at a profit in its location on the main floor. The assistant merchandise manager estimated that from 60% to 70% of the

men's furnishings sold in the Vadner Department Store were purchased by women.

If the men's clothing department were discontinued, there would be a question as to how the space so released could be utilized. The yearly rental charge was $11,250, and any department occupying the space would be charged in addition with approximately $60,000 of indirect expense annually. If no department utilized this space, these indirect expenses would be decreased about $6,000 because of reduction in such expense items as receiving, marking, and inside delivery. Since the space was not near the main lines of traffic in the store, it would have to be used by a department which would attract its own customers. One possibility was that the space might be used for a hair dressing and manicure shop for women. The store operated a small manicure shop on the third floor, but the executives were contemplating the establishment of an improved shop, which might be more effective in drawing customers into the store. The space released by the removal of the men's clothing department would be about the amount needed for this shop. As another alternative, the space might be used for the women's shoe department, which then was located on the second floor of the main store. That department had annual sales of about $340,000. If the women's shoe department were moved, more space in the main store would be available for the expansion of other departments. In general, however, the store was not handicapped by lack of adequate floor space for its selling departments.

Commentary: The primary cause for the unsatisfactory showing of the men's clothing department in this department store was the use of the same sort of merchandising methods in that department as were applied to the women's shopping departments. The reasons advanced for continuing to operate the men's clothing department, as well as the losses sustained in that department, all indicate a failure to comprehend the merchandising problems involved.

The argument that the department should be continued as a "service department," to create good-will for the store, had no firm foundation. The bulk of the merchandise in other departments was sold to women. They would not have missed the men's clothing department. In fact, if the loss in the men's clothing department had been eliminated and an equal amount spent for giving better values in some other department,

more good-will could have been generated. The results do not indicate that the store would have been at a competitive disadvantage with other department stores if the department had been discontinued. In the men's clothing department, in fact, the store was competing with men's clothing stores rather than with other department stores, and the men's clothing stores, if they were at all typical, used merchandising methods that were sounder than those of the Vadner Department Store.

Since 60% to 70% of the men's furnishings were sold to women in this store, the notion that it was necessary to carry men's clothing so that a man could purchase a complete outfit in the store was superficial. A man's suit or coat at a price of $45 or $50 is a primary purchase, whereas furnishings are accessories.

The buying of merchandise of lower value by the store to be sold at so-called "clearance sales" of the regular line of men's clothing on which genuine mark-downs were taken was poor merchandising. Not only was it unethical, if an impression was given to the public that all the merchandise offered was marked down in price; but the effect was to injure the reputation of the store, because the tendency would be for customers to rate the entire department by the poorest values that it offered. This practice, furthermore, had resulted in the accumulation of stocks of goods that were greatly overvalued. The average retail price of the merchandise on hand in the department after the clearance sale in January, 1925, was twice the retail market price. The store showed a large net loss for the department on its books, but the statement regarding the overvaluing of the inventory indicates that the real loss was nearly twice as great as that shown.

Under existing conditions the merchandise manager undoubtedly was correct in his opinion that the department could not be made to show a profit in the near future. A profit was not likely even in the distant future if the same merchandising methods were continued.

Two courses of action were open to the executives of the Vadner Department Store for averting the loss in this department. One course was to merchandise the department on a man's specialty basis rather than on the woman's shopping plan, with the discontinuance of the practice of buying lower-grade merchandise for the special sales. The location of the department in the store was suitable for such a specialty department. The other option was to discontinue the men's clothing department.

If the space had remained unused, the loss would have amounted to $11,250, the annual rent for that space, plus the burden of the indirect expenses, $54,000, that would have been transferred to other departments. The loss shown on the books to have been incurred in operating the department in 1924 was $33,600. The actual loss was

less, however, by the amount of the loading, 6% of the billed cost of the purchases. Since the net sales were $410,000 and the maintained mark-up 22.4% of net sales, the billed cost of goods sold was $318,160, and the loading credit, therefore, was $19,089.60. This indicates that the actual loss incurred by the department was approximately $14,510. Unless other means could have been found for using the space profitably, a change in merchandising methods should have been made in preference to discontinuing the department, for the discontinuance would have resulted in a loss greater than the loss incurred by operation.

July, 1926 M. T. C.

Henderson Company[1]

DEPARTMENT STORE—ELECTRICAL APPLIANCES

Merchandising—*Addition of Competing Brands to Line.* Prior to 1924 the company had carried only one brand of electric washing machines. The machines were purchased at wholesale from a local public utility company, which made deliveries to consumers and provided repair service. The gross margin on the machines sold by the department store was slightly less than the average expense of operating the appliance department, in which the machines were included. In an effort to enhance the profits secured on sales of washing machines, the company added to its line two more brands of washing machines, of the same grade as the brand already carried but on which the gross margin was greater.

(1924)

For several years, the electrical appliance department of the Henderson Company's store had sold one type of electric washing machine under the manufacturer's brand name, "Diana."[1] The manufacturer stipulated the price at which the machine was to be sold by retailers. Because of the low mark-up obtainable on this washer, the Henderson Company estimated that it suffered a loss on each machine sold. The buyer for the department, therefore, in March, 1924, inquired about other electric washing machines and learned that the differences between the stipulated retail prices and the wholesale prices at which two manufacturers sold their machines were larger than was the gross margin obtained on the Diana. He presented this information to the merchandise manager of the Henderson Company and requested his advice as to whether the department should stock either or both of those brands of washing machines.

The Henderson Company's store was located centrally in the shopping area of a large city in the Middle West. The company's total annual net sales were approximately $20,000,000. A large portion of the merchandise sold was in the upper medium-price classification. Charge accounts were opened for customers with satisfactory credit standings.

[1] Fictitious name.

The electrical appliance department of the Henderson Company was situated near the side windows on one of the upper floors of the store building. That department usually employed three salespersons. It sold electrical appliances of all kinds, including vacuum cleaners, heaters, ice machines, percolators, toasters, and irons. The department carried several of those articles in more than one manufacturer's brand. Other departments on the same floor sold kitchen furnishings, such as towel racks and holders, pots, pans, and kettles, and such hardware as tools and locks. The store sold about 250 Diana washers yearly. Operating figures for the electrical appliance department as a whole for 1922 and 1923, as shown on the books of the company, are given in Exhibit 1.

Exhibit 1

Sales, Expenses, and Stock-Turn of Electrical Appliance Department of Henderson Company, 1922–1923

Season	Sales	Expense in Percentage of Sales	Stock-Turn—Times per Season
Spring, 1922	$88,200	18.3%	10.1*
Fall, 1922	42,350	27.6	1.6
Spring, 1923	32,340	25.4	2.1
Fall, 1923	35,770	26.1	2.0

*The stock-turn for this period was influenced by an unusually extensive special sale.

The general methods of merchandising in the electrical appliance department differed in several ways from the methods used in other departments of the store. The salespersons, whether men or women, had to be specially instructed in the mechanical features of the appliances. It was necessary that the salespersons be able to explain the technical advantages of one make over another and the types of current and the voltage necessary for the proper functioning of the appliances. The merchandise manager estimated that it took about six months to train a salesperson properly for that department. Special provision had to be made for repair and service work on electrical appliances in use by customers. A repair man was employed by the electrical appliance department, and was sent, at the company's expense, to repair appliances which broke down within the period for which they had been guaranteed. After that period, repairs were made

free or were charged to customers, according to circumstances.

Electric washing machines were unlike most other department-store items in that practically all such machines bore manufacturers' nationally advertised brands and were sold at uniform resale prices. Moreover, since the unit price of a machine was large, the machines frequently were sold at retail on some plan of deferred payments. Approximately 90% of the Henderson Company's sales of washing machines were made on a deferred-payment plan. Subject to the approval of the credit department, the company permitted customers to purchase furniture, rugs, and house and kitchen furnishings on deferred payments. The deferred-payment plan was uniform for all those departments: the customer made an initial cash payment of 20% of the selling price and paid the balance in four, six, eight, or ten monthly instalments, plus 6% interest per annum on the balance of the account due at the end of each month. Because of the definite resale price and the deferred-payment plan, the company seldom took sales mark-downs on electric washing machines. The machines were not subject to deterioration, rapid style decadence, or radical price changes. The number of washing machines returned after purchase was negligible.

The store made fully 85% of its sales of electric washing machines to women. So far as could be learned, women who expected to purchase electric washing machines visited several stores and compared the mechanical features, appearance, and prices of the various models shown. A delay of several hours or days usually occurred between a customer's first inspection of a machine and her final purchase. The buyer for the electrical appliance department was of the opinion that women bought electric washing machines chiefly in order to lighten the work of laundering and to shorten the time required for that work, and that they were influenced in their selection of a machine chiefly by its probable efficiency in operation and economy in use. The store's largest sales of electric washing machines were in March and April, although many of the other articles in the electrical appliance department were sold in their largest volume during the Christmas season.

The Diana washer was of the vacuum type. It was composed

of an iron stand holding a large copper container within which three inverted bowls moved up and down in unison when the machine was in operation. A clothes wringer was attached to the iron stand. All the moving parts on the machine were driven by an electric motor. The articles to be laundered were placed in the container with a quantity of water and flaked soap. The motor operated the inverted bowls, which alternately pushed the articles to be washed against the bottom of the container and sucked them away from the bottom. The construction of the Diana washers was such that they operated satisfactorily for many years and seldom required repairs or replacement of parts.

The plant in which Diana washers were manufactured was about 200 miles from the Henderson Company's store. A public utility company controlled the wholesale distribution of Diana washers in the city in which the Henderson Company was located. The utility company sold the washers at wholesale to the Henderson Company and to one other department store, which, on the whole, sold merchandise in a lower price range than that sold by the Henderson Company. The utility company also sold Diana washers at retail. No exclusive retail agencies were granted by the manufacturer of Diana washers. The public utility company sold Diana washers to the stores for $115 apiece and retailed them at the nationally advertised price of $145. The utility company allowed the department stores a cash discount of 2% for payment within 10 days. The manufacturer of the washing machines advertised them nationally and guaranteed them for one year. The public utility company advertised the Diana washers in the local newspapers; the Henderson Company did not advertise the washing machines. Whether the machines were purchased from the department stores or from the public utility company, that company delivered the machines to consumers and furnished service and repair parts whenever necessary. The Henderson Company did not carry a stock of these machines but sold from a sample machine in the store. The public utility company retailed Diana washers on a deferred-payment plan under which a customer made an initial payment of $10 and paid the balance in 12 monthly instalments of $12.50 each. Occasionally, in special circumstances, the utility company

accepted an initial payment of $5 and monthly payments of $2. Under this latter arrangement the total price was the same as it was on the basis of $10 down and $12 a month.

For comparison with the operating figures of the electrical appliance department, Exhibit 2 gives operating figures for the misses' dresses department of the Henderson Company for 1922 and 1923. Misses' dresses were regarded as typical of the shopping goods sold by the Henderson Company. Nine salespersons were employed in that department.

Exhibit 2

Sales, Expenses, Gross Margin, and Stock-Turn of Misses' Dresses Department of Henderson Company, 1922–1923

Season	Sales	Expense in Percentage of Sales	Gross Margin	Stock-Turn—Times per Season
Spring, 1922	$39,900	21.3%	28.1%	3.6
Fall, 1922	51,800	22.3	26.9	4.9
Spring, 1923	55,300	22.3	30.2	4.8
Fall, 1923	74,200	23.0	26.3	5.6

In purchasing such merchandise as misses' dresses, the department buyer always had to consider style. Purchases frequently had to be made before conclusive evidence was obtainable as to the exact type of garment which would prove popular. The size of the stocks of dresses also had to be regulated so that the store would not have a large inventory of merchandise after the styles ceased to be popular. Because of style changes it sometimes was necessary for the department to resort to mark-downs in order to sell the remaining merchandise. Special sales of advantageously purchased merchandise were held in order to utilize a price appeal, which was judged to be strong in this type of merchandise.

Because it did not seem possible for the electrical appliance department of the Henderson Company to make a profit in selling the Diana washers on the gross margin allowed, the buyer investigated other available brands of washing machines. He found two nationally advertised electric washing machines, called "Vacuum Bowl"[2] and "Excellent,"[2] either of which would fit the requirements of the store and yield the store a larger gross

[2] Fictitious name.

margin than it obtained on the Diana washer. The store had ample storage space available for such products.

The Vacuum Bowl electric washer was similar to the Diana washer in that it was made with a copper container in which inverted vacuum bowls moved up and down. It had two inverted bowls instead of three and an additional set of gears which carried the shaft holding those bowls one-quarter of a turn around the cylindrical container during each up and down movement of the plunger. The buyer was of the opinion that the Vacuum Bowl washer was constructed of stronger materials and was better made than the Diana washer. The price of the Vacuum Bowl washer was $95 f.o.b. factory, and the freight rate from the factory to the store was $1.75 per machine. The usual retail price of the machine was $165. The Vacuum Bowl washer was advertised nationally but not so frequently as was the Diana washer.

The Excellent washer was of what was known as the oscillating type. It likewise had a cylindrical copper container for the articles to be laundered, but instead of being stationary and vertical the cylindrical container was horizontal and rocked back and forth on its axis. The inside was corrugated to resemble a washboard and the motion of the container rubbed the clothes on the corrugation. This machine, like the other two brands, had an electrically driven clothes wringer attached. The Excellent washer was advertised to about the same extent as was the Vacuum Bowl washer. The Excellent washer was made in three sizes, costing at wholesale, f.o.b. factory, $55, $85, and $100, and selling at retail at $90, $140, and $165, respectively. The freight rate from the factory to the store was $1.50 per machine.

Both the Vacuum Bowl washer and the Excellent washer were guaranteed by the manufacturers for one year. If it sold these machines, the Henderson Company would have to carry stocks of the machines, make deliveries to customers, and provide for repair work and replacements. The manufacturers both allowed retailers $1 for service on each machine sold. New parts could be obtained from the manufacturers in about two weeks. From previous experience the buyer for the electrical appliance department expected few mechanical troubles from the washing machines and thought that the allowances made by the manufacturers

were sufficient to cover the cost of any extra services necessary. Exclusive agents' rights, furthermore, probably could be obtained from either or both manufacturers without guaranties by the Henderson Company as to minimum sales per year. Although the Henderson Company had not advertised Diana washers, the buyer recognized that it might be advisable to commence newspaper advertising for the new brands, on which larger gross margins were obtainable. The buyer estimated that the cost of stocking and delivering these washers, exclusive of freight, would be about $3 per machine. The company probably would not purchase fewer than six washers at a time, although it could order as small a number as it desired.

The Henderson Company decided to sell both the Vacuum Bowl washer and the Excellent washer in addition to the Diana washer. Although the company believed it experienced losses on sales of Diana washers, it decided to continue to sell them because some of its customers preferred that brand. Moreover, sales of Diana washers increased the total volume of sales made by the department and thereby assisted in meeting the overhead charges. The store sold Excellent washers in three sizes. By selling the additional lines, the store made it possible for customers to examine and compare several types and models of washing machines without leaving the department. The store advertised the Excellent and Vacuum Bowl washers but did not advertise the Diana washers. The store's credit terms for the new machines were the same as for the Diana washers.

Sales of the electrical appliance department were about $3,500 less in 1924 than in 1923. The expense percentage remained approximately the same, but the rate of stock-turn was less. During 1924 the sales for the entire store increased; the sales in the misses' dresses department, for example, increased about $15,000, while the expenses and stock-turn in that department remained about the same as in the last half of 1923.

COMMENTARY: The decline in sales in the electrical appliance department in 1924 could not be attributed solely, if at all, to the addition of Excellent and Vacuum Bowl washing machines to the store's line. The decline might have resulted from factors affecting the sales of other items in the department, from inadequate advertising, or from

poor salesmanship; yet, inasmuch as the sales of the entire store increased and such departments as the misses' dresses department continued to prosper, the experience of the electrical appliance department was not typical. In the face of that evidence, it will be necessary to have strong reasons if a conclusion is to be reached favorable to the company's decision to increase the number of brands of washing machines which it carried.

The first question is whether the company should have concentrated on one make of washing machine instead of carrying three. By stocking several makes, the store afforded consumers opportunity to make comparisons of different machines within the one store, a practice common in other departments in a department store.

When the company decided to add two more brands of washing machines, however, it was imposing a more difficult task on its salespeople, and assuming the expense of carrying larger stocks of repair parts. A still greater disadvantage in multiplying the number of lines carried was the obstacles to effective sales promotion which that procedure interposed. The machines were technical in nature. They were competitive. The store could not well recommend to consumers the purchase of one make in preference to the other two; nor could it with good grace set forth the competitive merits of all three simultaneously. For promoting the sale of these machines, nevertheless, the use of forceful sales methods by retailer as well as by manufacturer was desirable. The company's decision handicapped it in using such methods. It would have been sounder policy for the company to have concentrated its sales efforts on a single make of washer.

The conclusion just stated, it should be pointed out, might have been different if the three makes of washing machines had been of distinctly different grades. The conclusion might also have been different if the store had undertaken to carry practically every make of washing machine, and to attract patronage on the grounds that it had a complete variety for selection, without emphasis on any one make.

If the company had decided to concentrate on one make of washing machine, some other brand than the Diana probably should have been preferred under the circumstances. The reason for that statement is not the store's estimate that a loss was incurred on Diana washers, for the saving resulting from the assumption by the public utility company of advertising, storage, delivery, and maintenance expenses probably offset the difference between the gross margin on Diana washers and the average gross margin on other goods in the appliance department. The chief reason for concentrating on one make of washing machine would have been to enable the store to undertake individualized sales

promotion plans, and that could not have been done by the Henderson Company for Diana washers while the local distribution of that brand was under the control of the public utility company.

This case illustrates the fact that in merchandising a specialty good with a high unit price a department store must utilize sales methods different from those applied in its shopping departments.

March, 1926 M. T. C.

Lee Shirt and Collar Company[1]

MANUFACTURER—SHIRTS AND COLLARS

Distribution Channels—*Exclusive Agencies as Alternative to Dense Distribution.* The company, which manufactured men's shirts of high quality, had granted exclusive agencies to retailers when it anticipated that such arrangements would increase its sales volume in the cities where those retailers were located. In other cities the company sold shirts to numerous retailers. A department store requested an exclusive agency for the company's brand of shirts. Although it was to continue to sell other brands of shirts, the store offered to purchase annually a larger quantity of the company's shirts than had been bought annually theretofore by the four stores in the city which sold those shirts.

(1922)

The Lee Shirt and Collar Company had been in operation since 1870. Its reputation had been built up by careful attention to quality and by national advertising on a moderate scale. It had 56 salesmen selling directly to retailers from 10 branch offices in the United States. Its collars and shirts were sold only under the Lee brand. The sales of the Lee Shirt and Collar Company had shown only a nominal increase for four years prior to August, 1922. A new sales manager employed in that year was convinced that the company's policy of granting exclusive agencies in several large cities instead of selling to numerous retailers in each city was partially responsible for this lack of development. The management had had the question of discontinuing exclusive agencies under advisement for almost two months when the Durrell Department Store[1] applied for the exclusive agency for Lee shirts in the city in which the store was located.

The Durrell Department Store operated a men's furnishings and clothing department in which the sales of shirts amounted to about $25,000 a year. All merchandise handled in the department was of first quality. The department's clientele included both men and women. The sales manager of the Lee Shirt and Collar Company estimated that in general 60% of the men's shirts sold in retail stores were bought by women. The Durrell

[1] Fictitious name.

Department Store had a modern building located in the center of the shopping district. It was one of four stores in the metropolitan district which had been carrying Lee shirts and collars in stock; four other stores also sold Lee collars but did not carry Lee shirts. The combined sales of Lee shirts in the district amounted to $21,000 in 1921. If it was granted the agency, the Durrell Department Store not only would agree to place a minimum order of $22,500 for Lee shirts during the next year, but would also agree, even though it continued to carry other brands of shirts in stock, to devote special advertising and sales efforts to Lee shirts and to use the greater part of its shirt display facilities for the Lee line. In asking for the exclusive agency, the management of the Durrell Department Store called attention to the fact that the Durrell Department Store's advertising of Lee shirts would have value not only in the city and its suburbs, but also throughout a much wider area because of the wide circulation of the city newspapers.

The Lee Shirt and Collar Company had granted several exclusive agencies for shirts in large cities. It had considered each request on its merits, the primary consideration being volume of sales. When the combined sales in a city had not equaled the amount which a store would agree to take when asking for an exclusive agency, the request usually had been looked upon with favor. In order that an agency be granted, it had been necessary, however, for a store to meet the company's requirements as to local prestige, location, and quality of merchandise carried.

The executives of the Lee Shirt and Collar Company were of the opinion that Lee shirts, because of materials and workmanship, were of a quality which only a store with a clientele which demanded high-grade merchandise could afford to carry. For this reason, the executives theretofore had concluded that ordinarily an exclusive agent with such a clientele, who would make special advertising and sales efforts, could secure larger sales of Lee shirts than would be obtained in the aggregate by several stores selling in competition and not giving special attention to any one brand.

In selling collars, which amounted to about one-half its total sales, the Lee Shirt and Collar Company had followed a different

policy. The company had sought to secure general distribution, on the ground that consumers commonly bought collars in stores that were conveniently located. Theretofore, when an exclusive agency for shirts had been granted, there had been a question of the probable effect on collar sales. In such instances the sales manager, however, had explained frankly to the other retailers in the city that the company's business could be increased by concentrating shirt sales in one store and that its interests required the change. As a result the company usually had succeeded in retaining the patronage of retailers selling its collars.

COMMENTARY: The Lee Shirt and Collar Company apparently was drifting along in marketing its products without a definite, coordinated merchandising plan. It lacked a real policy with regard to the granting of exclusive agencies. There is no indication that it had determined whether it should aim at stimulating the demand from men or at effecting sales to women. The buying motives to be aroused differed for the two types of market, and the merchandising plan should not have been the same for both types.

Although the sales manager of the company estimated that in general 60% of the men's shirts sold in retail stores were bought by women, the evidence regarding the quality of materials and workmanship employed in the manufacture of Lee shirts indicates that the product was one for which a special demand might have been stimulated among men. If a policy were to have been adopted of focusing the merchandising plan on sales to men, then the request of the Durrell Department Store for an exclusive agency for Lee shirts should not have been granted even though the store offered to buy more Lee shirts annually than the company previously had been selling in the city. The store apparently was a typical department store, which received the bulk of its patronage from women. If the Lee Shirt and Collar Company had granted the request for the agency, it would have been barred from securing distribution of its shirts in specialty shops patronized by men of the type likely to buy its grade of merchandise. Although an exception might be made in the case of a store which operated a strongly organized specialty department, an exclusive agency ordinarily should not be granted to a department store for the sale of an article that is purchased chiefly by men.

February, 1926 M. T. C.

Chocolink Beverage Company[1]

SELLING AGENT—CHOCOLATE PREPARATION

Distribution Channels—*Exclusive Retail Agencies for Introducing Convenience Goods.* The company, a selling agency controlled by a manufacturing company, acquired exclusive sales rights to a chocolate preparation manufactured by secret process and used chiefly, with milk or water, as a base for a beverage. The manufacturer had attempted to market the product through wholesale grocers, but without success. Distribution then had been undertaken through retail milk companies, which undertook aggressive selling methods for the product. In view of its limited financial resources, the sales company decided to continue to sell the product through retail milk companies, granting them exclusive agencies, rather than to undertake the larger expenses of securing distribution in retail grocery and retail drug stores.

(1924)

For three years the Hayden Company[1] had endeavored to secure a market for its product, but with only moderate success. The company manufactured Chocolink, a preparation composed of chocolate, cocoa, vanilla, sugar, and milk, which was sold in powdered form for use in making a hot or cold drink, fudge, frosting for cake, or a filler for sandwiches. The process of manufacture was secret but could not be patented. In 1923 the company had sold 1,000,000 pounds of Chocolink. Without additional investment, the factory could manufacture 1,500,000 pounds annually.

In December, 1923, exclusive sales rights to Chocolink were granted for 10 years to the Chocolink Beverage Company, a sales corporation controlled by the president of the manufacturing company. The Chocolink Beverage Company considered the relative advantages of marketing the product through wholesale grocers and wholesale druggists, through retail milk distributing companies, and directly to retail grocers and retail druggists.

The Chocolink Beverage Company was capitalized at $25,000; stockholders were willing to subscribe $10,000. To secure additional funds, however, the corporation would have had to apply to other individuals or to banks. Individuals lending to the corporation might have required a controlling interest in it, and

[1] Fictitious name.

the president knew of no bank that would lend to the company until it could show a profitable operating statement. The Chocolink Beverage Company would not maintain stocks of finished product; it was estimated, however, that $12,000 of the $25,000 capital would be in accounts receivable or in cash. The remainder was to be utilized for sales promotion. Credit was to be extended to customers for 10 days only.

The Hayden Company had stressed the use of Chocolink as a base for a beverage, because the company had been convinced that that would be the most popular use for the product. The drink was prepared by mixing a small quantity of boiling water with the powder and then adding hot or cold milk or water. The milk content of the powder was 2.5%. The Hayden Company figured that the total cost of manufacturing and packing Chocolink was slightly more than 19 cents a pound. The largest single cost was for materials; about 50% of that cost was for sugar. The powder was packed in one-pound containers for retail distribution.

The retail price of Chocolink in 1923 had been 35 cents a pound; the Hayden Company had sold the product to distributors at 25 cents a pound. According to the contract between that company and the Chocolink Beverage Company, the sales company was to pay the manufacturer 21 cents a pound; 10 days' notice of any change in price was to be given by the manufacturing company. It had been proposed that the retail price recommended by the manufacturer be raised to 40 or 45 cents a pound. No action, however, had been taken on this proposal.

The chief competing product of Chocolink as a drink was marketed in fluid form. After a bottle of that preparation was opened, the preparation spoiled within a week, it was stated by representatives of the Chocolink Beverage Company; whereas, an open package of Chocolink stored in a dry place would not deteriorate for several months. A 40-cent bottle of the liquid preparation, when properly diluted, made approximately one-half as much beverage as a 35-cent package of Chocolink mixed to the same consistency. The liquid preparation was marketed through retail milk distributing companies. Another competing product was sold in powdered form. It retailed at 50 cents for 8 ounces and was sold by the manufacturing company's salesmen to retail

grocers and druggists. That product, however, was not so soluble a preparation as Chocolink and could not be prepared with cold milk. Chocolink had an advantage over ordinary chocolate and cocoa in that it could be prepared instantly, without cooking.

In 1921 the Hayden Company had made an experimental attempt to distribute its product through wholesale grocers in Connecticut. That state had been chosen because the president of the company had been acquainted with those wholesalers. The company had spent $3,000 for advertising and in employing specialty salesmen; wholesalers and retailers had purchased the product, but consumers had manifested no interest in it.

After this failure, the Hayden Company had made an effort to secure distribution by granting exclusive agencies to milk distributing companies. Fourteen such companies had accepted agencies. The product was retailed in one-pound boxes from their wagons. Because the use of Chocolink increased the demand for milk, the Hayden Company had expected that those milk companies would urge their drivers to sell the product. The wages of the drivers were the same whether their wagons were loaded fully or only partially. Consequently, by selling Chocolink, the milk companies lowered unit costs of distributing milk slightly, since existing equipment was utilized and fixed charges were not increased. The 14 companies had sold 1,000,000 pounds of Chocolink in 1923. The more aggressive of those milk companies had succeeded in selling satisfactory quantities of Chocolink and in so doing had increased their sales of milk.

The following excerpts concerning the distribution of Chocolink were taken from the contract between the Hayden Company and the milk distributors:

> The company agrees to sell to the distributor as much of said powder as the distributor shall require from time to time during the term of this agreement or any extension thereof for distribution in said territory, and that it will not during said term knowingly sell any of said powder to any other person for distribution in said territory.
>
> The distributor agrees not to distribute or sell any of said powder outside of said territory, nor to sell or distribute any of said powder under trade-mark, trade name, or designation other than Chocolink, and not to use, handle, or sell any other powder, syrup or other preparation used for the same or any similar purpose, during the term of this agreement.

The sales manager of one of the milk companies which had been most successful in selling Chocolink was convinced that the Hayden Company had used the most advantageous method of distribution. That milk company had advertised Chocolink in local newspapers and had displayed signs on its wagons which indicated that a customer could secure Chocolink by ordering it from the driver. The milk company also had undertaken a campaign to increase sales; samples of Chocolink had been distributed and salesmen had called at the houses where the company's milk was delivered; booths for the sale of Chocolink had been operated at trade expositions and at several amusement parks. Sales of Chocolink had trebled in that milk company's territory following this sales promotion, but later they had declined until they were only 50% more than the sales preceding the campaign.

The executives of the Chocolink Beverage Company learned that east of the Mississippi River there were 56 milk companies which would make suitable exclusive agents for Chocolink. If each of those companies ordered 8,000 pounds per month, which was the quantity of Chocolink distributed by one milk company, the annual sales would be 5,376,000 pounds. The executives recognized, however, that drivers of milk wagons could not always be depended upon to make an effort to sell Chocolink. Drivers were paid straight salaries and were interested in distributing milk as quickly as possible. In most localities, because of competition, one milk company did not have complete distribution. The president of the Chocolink Beverage Company stated that many milk companies hesitated to act as agents for Chocolink because they had been unsuccessful in marketing similar products.

As an alternative to distribution through milk companies, it was proposed that Chocolink be sold exclusively to wholesale grocery and wholesale drug companies. Under this plan the sales corporation would employ specialty salesmen to introduce the product to wholesalers and to secure orders from retailers to be filled by wholesalers. When wide distribution to wholesalers had been secured, the Chocolink Beverage Company would undertake a general advertising campaign. If specialty salesmen were necessary after the product was introduced, they could

secure orders from retailers for the major part of the retailers' requirements. Wholesalers could fill those orders and could accept and solicit additional orders. The adoption of such a plan might result in national distribution quickly. Products similar to Chocolink were marketed in this way. Since wholesale companies had storage facilities, they accepted quantity shipments; this rendered it unnecessary for the manufacturing company to make provision for extensive warehouse space. The executives of the Chocolink Beverage Company believed that for the most part wholesalers were satisfactory credit risks. The sale of Chocolink at soda fountains, moreover, which would be insured by distribution through wholesale druggists, would have advertising value.

The president of the Chocolink Beverage Company objected to this plan because of the experience of the Hayden Company in distributing Chocolink through wholesale grocers in Connecticut. The average wholesale grocer or wholesale druggist distributed hundreds of different articles; it was his function to furnish those which were in demand rather than to develop a market for new products. The president was of the opinion that since the Hayden Company was not prepared to manufacture enough Chocolink for national distribution, it might be advisable to concentrate sales efforts in limited territories. Production, however, could be increased 50% with an expenditure of only $2,500 for additional machinery. No extra space would be required. The Hayden Company furthermore had another plant which could be utilized for the manufacture of Chocolink if sales increased more than 50% of existing capacity.

By establishing its own sales force and selling Chocolink directly to retail grocers and druggists, the Chocolink Beverage Company would be able to select the retailers to whom it wished to sell, to control distribution and sales effort closely, and to obtain a larger gross margin than could be obtained on sales to wholesalers. The cost of maintaining an adequate sales force would be large, however, and in order to sell directly the company would have to carry stocks at warehouses and to open accounts with numerous retailers.

The Chocolink Beverage Company also considered marketing Chocolink through chain stores. In that way wide retail distri-

bution might be secured with one or two salesmen, because of the central buying agencies of the chain store companies. Chain stores usually carried their own reserve stocks and frequently contracted for a year's supply in advance. The number of those stores was increasing, and they were widely patronized. It was the opinion of the executives, however, that as a rule chain stores did not undertake to introduce or to create a demand for new products. It was possible, moreover, that unit stores would refuse to sell Chocolink if its distribution through chain stores proved unsatisfactory.

The Chocolink Beverage Company decided to market Chocolink through milk distributing companies if possible. The company employed two salesmen to attempt to establish exclusive agencies with the leading milk distributing companies east of the Mississippi River. The president of the company was thoroughly convinced that, in view of the limited capital of his company, distribution by means of retail milk distributing companies was the most satisfactory method.

Commentary: This is an example of a problem typically faced by a company with meagre financial resources which seeks to introduce on the market a new product of merit. If the company had been able to command adequate capital on acceptable terms to finance its operations for several years, it probably would have undertaken an extensive program of advertising to consumers, either locally or on a national scale, and it would have sought to have its product placed on sale in as many retail grocery stores and retail drug stores as possible. The article quite clearly belonged in the class of convenience goods and therefore should have attained dense distribution.

Under the circumstances, however, a plan of such broad scope was not feasible for the company. Its task was to find a satisfactory alternative plan, either for temporary or for permanent use. Even though it was not conclusive, the experiment tried in Connecticut was discouraging to an attempt to distribute the product through ordinary wholesale and retail trade channels. The failure may have resulted from poorly prepared advertising copy, poor selection of mediums, or inadequacy of the amount spent for sales promotion. The sale of 1,000,000 pounds by 14 milk companies in 1923 proves that the interest of consumers in the article could be aroused and that they made repeat purchases. The inference to be drawn from this fact is that the failure of the Connecticut experiment was not to be accounted for

by an inherent weakness in the plan itself but by poor execution. Whatever the cause of the failure in that instance, however, the company was not disposed to risk its meagre capital in further experiments of that sort.

The proposal to sell directly to unit stores deserves no serious consideration. The cost of selling a single article of low unit value directly to unit stores would have been prohibitive. That plan, moreover, would not have coped effectively with the basic problem of appealing to consumers' buying motives. The proposal of seeking orders from chain store companies likewise held little promise, since those companies seldom were willing to take on a new product until a substantial demand had been stimulated among consumers.[2]

This seems to lead to the conclusion that the retail milk companies afforded the most promising means of marketing Chocolink. Those firms to which agencies were granted obtained an opportunity for increasing their earnings without adding heavily to their expenses. If 56 companies each had sold annually a quantity of Chocolink as great as the average quantity sold by each of the 14 dealers in 1923, the company's sales would have amounted to 4,000,000 pounds a year. This was substantially more than could have been produced in the company's plant even with the expenditure of $2,500 for the purchase of additional machinery. Inasmuch as another plant was available, however, the increase in sales up to 4,000,000 pounds a year could have been provided for. That volume of sales, it seems, would have been satisfactory to the company.

So far as the preceding analysis goes, it indicates that the Chocolink Beverage Company was fortunate in having a product in which milk retailers could be interested so easily. Seldom does a company with a new product to introduce find such a simple solution.

Although the soundness of the company's decision to market its product through milk retailers is granted on grounds of expediency, it is not wholly satisfactory to let the case rest there. Two contingencies have not been provided for: (1) the danger that the secret process may be duplicated by another company with greater financial resources; and (2) the possibility that at some later date a further expansion of sales may be desired.

If a competitor were to duplicate the company's secret process and execute a comprehensive plan for advertising to consumers and effecting distribution in numerous retail grocery and retail drug stores, the competitor could feature his brand more strategically than the Chocolink Beverage Company could feature Chocolink.

In a single city one milk company served only a portion of the

[2] See Garry Company, page 205.

population. The consumers who purchased milk from other milk companies would remain ignorant of Chocolink. A substantial segment of the potential market in each city, therefore, would not be reached by the plan on which the company had decided. There would be a constant temptation to seek to exploit the undeveloped demand or apprehension that failure to do so would leave an easy opening for a competitor to enter the market.

If the company were to reach a stage eventually at which more thorough exploitation of the potential market were to be attempted, the practice of relying on the milk companies would be a handicap, since it would be necessary for the company to shift distribution to retail stores and to risk a temporary dropping off of sales while the shifting process was being carried out.

While the plan which the company adopted may have been the most practical under the circumstances, it did not lend itself to a thorough exploitation of the potential market, nor was it invulnerable against competition.

March, 1926 M. T. C.

Strand Glove Company[1]

MANUFACTURER—GLOVES

Distribution Channels—*Development of Consumer Insistence to Promote Sales to Retailers.* The company sold the gloves which it manufactured directly to retailers in cities with populations of more than 25,000. The expense was too great, in proportion to potential sales, to warrant sending the salesmen to smaller cities and towns. It was proposed, therefore, to attempt to stimulate so strong a demand among consumers in the smaller cities and towns that retailers would be induced to order the gloves from the manufacturer by mail.

(1922)

The Strand Glove Company sold directly to retailers in the large cities in the United States, but the expense was held to be too great to justify sending salesmen into cities with less than 25,000 population. The desire to increase sales, however, brought up the question in 1922 of whether it would not be worth while to attempt to secure orders from retailers in the small cities.

The company employed 28 domestic salesmen, who visited their customers and potential customers once each spring and each fall selling season. In making up a season's line of samples, the company considered the style element in men's gloves negligible, but in women's gloves it played a large part, especially in lengths; although style variations in colors also occurred, the fact that leather did not readily take dyes restricted that style range. The company carried stocks only in the staple styles, lengths, and colors. It sold leather, cotton lisle, and artificial silk gloves. The leather and silk gloves were manufactured near Gloversville, New York, whereas the larger proportion of the lisle gloves were imported from Germany and France. In the domestic as in the foreign manufacture of gloves over 50% of the manufacturing process was done by workers in their homes, cutting being the chief operation performed in the factories.

The advertising agency which held the Strand Glove Company's account, submitted a plan designed to aid the company in selling gloves in small cities. That agency recommended that the company advertise during the autumn of 1922 in three issues

[1] Fictitious name.

of a national weekly, and in one issue each of a women's magazine and a "Quality Group" monthly. The text of the copy which the agency proposed to use in those three mediums follows:

WHY "A PAIR OF STRANDS" MEANS "A PAIR OF GLOVES"

When you say—

"I want a pair of Strands," to any American glove merchant, he is not likely to answer—

"Excuse me, what was it you wanted?"

He knows that you want gloves—good gloves. . . . . And he will show you Strands if he has them, or explain the merits of another brand.

It is much the same in London or Capetown, Melbourne or Cairo.

Wherever gloves are a recognized part of men's and women's apparel, you will find recognition of the name Strand.

But here is the danger of reputation: —while "Strands" stands for "gloves," all gloves are far from being Strands. A distinction with a difference!

For the retail dealer does not make the gloves he sells. . . . .

He may be a better judge of hand-wear than his customer, yet he, too, must rely on the maker's faithfulness in maintaining the promised quality.

The makers of Strands have kept faith with the trade and with glove wearers.

That is the only secret of Strand prestige. That is why the name represents very definite standards throughout the glove industry.

And that is why we stamp the name in the wrist of every pair.

You could not have a more reliable guide to reliable gloves, to authentic style, and to true economy.

Men and women spend little money and less thought on gloves, in comparison with the rest of their attire. Yet nothing improves their appearance so much, for such a small outlay.

The well-gloved man or woman is usually a well-dressed person.

Send us the name of your dealer if he cannot supply you, and we will send our booklet of 89 styles for men, women, and children.

STRAND GLOVE COMPANY
5th Avenue New York

In addition to this text each advertisement was to contain a cut of a pair of gloves with the name "Strand" prominently displayed on the buttons.

As a result of these advertisements it was expected that inquiries would be received from consumers giving the names of the

retailers from whom they purchased gloves. It also was hoped that the demands made upon small-town stores by customers desiring Strand gloves would be so great that retailers themselves would write to the Strand Glove Company requesting catalogs and samples. It was planned to follow up inquiries from consumers and retailers with circulars, showing prices, styles, and selling points of Strand gloves, and also to offer inducements to retailers to send for samples from which they could make selections. A plan had been worked out whereby retailers who ordered Strand products by mail would be able to secure each season a full line of samples. Assurance was to be given them that their orders would receive the same attention as those secured by the salesmen. A discount in price was expected to provide sufficient inducement for the retailers to send in their orders by mail.

Commentary: The advantages that would accrue to the company from the operation of this scheme, provided it were successful, were obvious. In its favor were the reputation of the company and the good quality of the merchandise. Nevertheless, the obstacles to be overcome probably were insuperable. The object was to create an attitude of insistence among consumers which would induce them to defer purchases when retailers did not have Strand gloves in stock, and which, furthermore, would lead them to send the names of recalcitrant retailers to the Strand Glove Company. The company then would attempt to persuade the retailers to purchase a stock of Strand gloves by mail.

The company's product was not so unique or distinctive in quality, nor was the amount to be spent in advertising so large, as to warrant faith that by this plan consumers would be persuaded to defer their purchases indefinitely, that they would write to the company in large numbers to give the names of retailers who did not carry Strand gloves, or that many retailers could be persuaded by correspondence to add Strand gloves to their stocks.

The advertising program that was planned might well have been of assistance in promoting sales of Strand gloves in cities covered by the company's salesmen, but it was not to be expected that the advertising would revolutionize consumers' buying habits in other cities and towns.

March, 1926 M. T. C.

Cardiff Manufacturing Company[1]

MANUFACTURER—TWINE

Advertising—*Promotion of a Fad.* The market for undyed jute twine manufactured by the company had been inexpansible. A small lot of dyed twine was offered for sale experimentally and a demand appeared unexpectedly among women, who used the twine for crocheting shopping bags and other small articles. The fad spread rapidly. The company's problem was whether to undertake a short intensive sales drive or a program extending over several years.

(1921)

Through the rise of the fad in the latter part of 1921 for crocheting purses, hand bags, and other small articles out of twine, the Cardiff Manufacturing Company, manufacturing jute twine, secured an opportunity to extend a theretofore inexpansible market.

The bulk of the company's sales had been made directly to large industrial users, such as rug manufacturers, and to the United States Post Office Department. Distribution to miscellaneous industrial users and to retailers, such as hardware stores and stationery stores, had been obtained through wholesalers. None of the products of the company ever had been branded, and the Cardiff name was practically unknown to household consumers. The market for packing twine had been stable, and it had been possible to estimate the annual consumption in advance with a high degree of accuracy. It was evident that the Cardiff Manufacturing Company had been securing its full share of business in open competition with other manufacturers of similar products.

During the summer of 1921 the company dyed a quantity of ordinary jute twine in various colors as an experiment. This twine was sold to two wholesalers in New England. Shortly afterwards orders for more colored twine were received from these wholesalers, and more dyed twine was made to fill the orders. Then additional orders for the item came in, and wholesalers inquired whether a wider variety of colors could be obtained.

[1] Fictitious name.

A representative of the company made an investigation in the cities covered by these wholesalers and found that the colored twine was being sold to women for crocheting shopping bags and other small articles. Here apparently was an opportunity to make the name of the Cardiff Manufacturing Company known to individual consumers. A variety of shades and colors were selected and balls of crochet twine made up with a Cardiff trade-name band around each. Specialty salesmen were employed by the company to call on department stores in New England to secure orders for Cardiff Crochet Twine. Direct shipments were made by express as soon as orders were received, but wholesalers were allowed their usual commissions on the sales. At the factory a designing department was established to work up samples of various novelties which might be made with the twine.

In order to build up a large demand for Cardiff Crochet Twine for the Christmas season, the Cardiff Manufacturing Company employed an advertising agency and appropriated $40,000 to be spent during the 10 weeks remaining before Christmas. The demand spread rapidly in New England cities, and so much business was secured that the Cardiff Manufacturing Company began making plans to extend this branch of its business so as to secure national distribution of Cardiff Crochet Twine.

This presented a problem as to whether the Cardiff Manufacturing Company should undertake a national advertising campaign extending over several years, or should spend the funds available for advertising in a short, intensive campaign; also as to whether the company should undertake primarily to secure national distribution through wholesalers, or should establish a showroom and sales office in New York City to attract orders from department store buyers visiting the city.

Commentary: The manner in which the demand for colored twine appeared indicated that use of the twine probably was to be a fad. A fad usually is shortlived. The demand for a fad can be intensified by aggressive sales methods, but its life seldom prolonged. The company, therefore, should have used such funds as were available for advertising in a short intensive campaign. In order to exploit the fad to the utmost, the company should have undertaken to sell colored twine directly to metropolitan department stores and to obtain orders from department store buyers visiting New York in the search for

novelties. When the metropolitan department stores led the way in offering such merchandise, their example ordinarily would be followed rapidly by department stores and dry-goods stores in other cities. Orders should have been accepted from wholesalers, but the wholesalers could not have been relied on to exploit the market fully. The wholesalers probably would have been so cautious in taking on such a new product that a heavy demand from them could not have been expected to materialize until the fad was well developed and, therefore, approaching the end of its popularity.

In marketing a fad, the largest results can be secured by applying intensified sales efforts at the outset at strategic points, rather than by the process of gradual development, which is suited for building a market for many other types of new products.

February, 1926 M. T. C.

Beaton & Company[1]

IMPORTER—PHONOGRAPHS

Distribution Channels—*Selection of Retail Distributors for High-Price Novelty.* The company secured the exclusive rights for importing and selling a small French phonograph in the United States. The product was a new invention, a novelty, and it was expected that the retail price would be between $25 and $35. The company previously had imported building materials and railway materials. Hence, it had no established relationships with retail merchants which would facilitate the initial distribution of the new article. It was necessary for the company to select a suitable type of retail distribution.

Sales Planning—*Reduction of Seasonal Fluctuations in Sales by Addition to Line—(Commentary).* The company imported cement, railway materials, and allied materials. It desired to offset the seasonal fluctuations in its sales, and for this purpose it arranged to import, under exclusive rights, a small French phonograph, which was of recent invention. The company was correct in expecting the sales of such a novelty to manifest different seasonal fluctuations from those of the other materials which it sold, but, since the same sales organization could not be used for both classes of merchandise, the company could expect no substantial economies from the nominal smoothing out of its aggregate sales curve.

(1924)

Beaton & Company imported cement, railroad materials, and, occasionally, other allied products. In 1924 the company desired to lessen the seasonal fluctuations of its sales, and, as a means to that end, decided to import other products, the sales of which would not fluctuate coincidently with the sales of the materials that it then was selling. In April, 1924, a representative of Beaton & Company, who was sailing for France, was instructed to secure for the company, if possible, the exclusive import and sales rights in the United States and Canada for a recent French invention, the Etoile,[1] said to be the smallest phonograph in the world. The representative was successful in his negotiations with the inventor. The contract under which the exclusive rights were granted was signed in May. The contract provided for the purchase by Beaton & Company of 10,000 machines yearly and could be terminated by the inventor at the end of any 3-year

[1] Fictitious name.

period during which 30,000 machines were not taken by the importer. Beaton & Company could terminate the contract at one year's notice.

In the latter part of November, 1924, Beaton & Company had not decided whether to distribute the Etoile through wholesalers or directly to retailers, the type of retail distribution to seek, the price policy to follow, or the advertising appeals to employ. The first shipment, of 300 phonographs, was due to arrive in New York for the Christmas trade.

The Etoile had been invented and patented in the spring of 1923. It was put on the market in France and England in June, 1924, and in October, 1924, further improvements in construction were made which were expected to render it mechanically satisfactory. The perfected Etoile weighed about 4 pounds, including the carrying case. That case, which was 2 inches by 4 inches by 8 inches, was made of wood and covered with leather. At first sight the case might be taken for a vanity box. A Thorens spring motor, with overall dimensions of 2 inches by 3½ inches by 5 inches, manufactured in Switzerland by the same company which manufactured the motor for a high-grade domestic cabinet phonograph, was attached by top and bottom plates to one end of the carrying case. That motor had been tested by engineers of a large American adding machine company and pronounced reliable in every respect. The motor consisted merely of a spring, two wheels, and a governor, and was designed to play a 10-inch or 12-inch record with one winding. It was constructed more solidly than was usual for so small a motor, in order to enable it to withstand hard usage. The solid construction also played an important part in the quality of tone and in the elimination of vibration.

All parts except the motor were detachable. The detachable parts included a turntable approximately 3 inches in diameter, a handle, a reproducer similar to those found in cabinet phonographs, but smaller, and an 8-sided, cone-shaped, collapsible horn approximately 8 inches in length and ½ inch to 3 inches in diameter. A patented disk, about 2 inches in diameter, screwed over the record into the turntable to prevent wabbling. The reproducer consisted of 8 separate parts and was so constructed that it could be used not only for Victor, Columbia, and similar records, but also for Pathé and Edison records. This versatility was obtained

by merely turning the reproducer to the left or to the right. The horn answered the same purpose as sounding boards and cabinets in large machines. The horn was fitted to the reproducer by a rubber connection which prevented mechanical and harsh sounds and absorbed disturbing vibrations. A swivel brace which fitted into the case held the horn and reproducer in place. The machine could be assembled in two minutes. Patents covered the rubber connection between the reproducer and the horn, the collapsible horn, the motor, the case, and the machine as a whole; the name was trade-marked. All parts except the motor were made in Paris, and the machine was assembled there.

In June, 1924, when the Etoile was sold first in France, it had but one competitor, the Carolphone,[2] which had been placed on the market about 3 months previously. The Carolphone was slightly larger than the Etoile, about 4 inches by 5½ inches by 6½ inches, weighed about 5 pounds, and was said to be constructed more cheaply. The reproducer, for example, consisted of one stamped piece. Neither the machine as a whole nor any part of it was guaranteed. Furthermore, it did not play Pathé records, which were said to be used more than any others on the Continent, or Edison records. The Carolphone was manufactured in England. In France it sold at a retail price of 300 francs and was distributed indiscriminately through any retailer who could be induced to stock it. The retail price of the Etoile was 320 francs.

The inventor of the Etoile first placed it on sale in a few music stores in Paris and London. Within a month, however, he sold all French and English sales rights to a large stationery and novelty chain store company operating more than 100 stores. The chain store company distributed the machine, through its own salesmen, directly to retailers. It restricted distribution to high-grade music stores, the best stationery and novelty shops, department stores, and its own branches, and refused to sell to stores which were likely to cut prices. The chain store company did not grant exclusive agencies except to retailers in small towns who agreed to take as many machines as it estimated could be sold there.

The new phonograph immediately outsold the Carolphone. Sales increased monthly, and the inventor could not produce

[2] Fictitious name.

enough assembled machines to meet the demand. By November, 1924, however, extensions to plant were completed which made possible the production of a sufficient number of machines to supply the Continental and English markets and to provide Beaton & Company with as many machines as it probably could sell. Ninety per cent of sales were made in Paris and London. Among the buyers were numerous American women tourists. Billboard posters, 5 feet by 8 feet, in glaring colors featured the Etoile as "the smallest phonograph in the world." The chain store company induced a prominent French actress to pose for a photograph while holding an Etoile, and featured that picture with the actress's testimonial in fashionable magazines. The only dealer help furnished was a photograph of that actress to be used as the nucleus of a window display. While using that window display, a retailer usually placed the Etoile on sale at a prominent point within the store and on request gave demonstrations of the machine in operation.

According to the representative of Beaton & Company, the Etoile was a topic of conversation at restaurants and at other gathering places where people discussed things that took their fancy. The price of the machine was low; its performance was reasonably good; and the machine was, moreover, a real phonograph. It afforded American tourists an attractive opportunity to fulfill their desires to take home "something French."

When shipped into the United States the new machine was subject to a 30% ad valorem import duty and would cost approximately $14, duty paid, landed in New York; that price was based on the rate of exchange prevailing in November, 1924, and assumed the use of materials of the highest quality throughout, the horn to be made of heavy English leather, and the case of selected wood with genuine leather covering in red, green, or natural color.

The representative of Beaton & Company found that in the United States two makes of phonographs were being sold which would compete with the Etoile machines. The Carolphone, which had been introduced about three months previously, as yet was sold only in New York City. It was distributed indiscriminately as in Europe and sold for $25 at retail. A sale of 20,000 Carolphone phonographs during the Christmas season in New York

was anticipated. The representative of Beaton & Company learned that an extensive advertising campaign to pave the way for national distribution of that phonograph was to be launched after Christmas.

The other phonograph which would compete with the Etoile sold at retail for $12.50. It was advertised in newspapers and was distributed throughout the United States, mainly by mail order. It was not guaranteed. The representative of Beaton & Company referred to that phonograph as being little more than a toy and did not expect it to be a serious competitor of the Etoile. Beaton & Company did not look upon the large portable phonographs or cabinet machines as direct competitors of the Etoile.

Upon his return to New York, the representative of Beaton & Company called upon numerous retailers and wholesalers to ascertain their views on the new phonograph from a merchandising standpoint. A majority of those interviewed stated that in their opinion the new machine could not be sold for more than $27.50 at retail. On the other hand, the head of a large retail company which sold phonographs stated that the Etoile could be sold as a high-grade article at a retail price of $35. Music retailers tentatively demanded 40% or 50% discount from the retail price. Several department stores agreed to accept a discount of 35%. One of the largest department stores in the city guaranteed to take the entire first shipment at 35% discount, provided that shipment arrived in time for the Christmas trade. Wholesale distributors of phonographs, such as drug wholesalers and musical instrument wholesalers, who were interviewed demanded a 10% margin on the retail selling price.

Beaton & Company estimated that its net profit should be at least 10% of the wholesale price, whereas, if the machines were sold at retail for $27.50 and at the discounts demanded, Beaton & Company's gross margin barely would meet the selling expenses and afford protection for fluctuations in exchange rates. Arrangements could be made with the French manufacturer for the use of cheaper materials so that the landed cost of the phonographs in New York would be approximately $11 per machine. A leather-covered cardboard horn could be substituted for the full leather horn, and minor changes in the mechanism of the motor and diaphragm could be made. Such changes would render the

machine as a whole less substantial without impairing, however, its tonal quality. In the opinion of the agent, the Etoile still would be superior in design and finish to the Carolphone. There was a further possibility that the cost to Beaton & Company could be reduced by quantity production in France, but nothing definite was known in regard to that.

Beaton & Company was willing, provided such expenditure was warranted, to spend $100,000 in arranging for proper methods of distribution and in establishing a demand for the new phonograph. The company desired to adopt merchandising methods which would give the Etoile a competitive advantage over the Carolphone. It was necessary for the representative of the company to decide immediately upon methods of distribution, to set a retail price and a wholesale price, to make the necessary arrangements with distributors, to organize a sales force and arrange routings for salesmen, to decide upon the types of advertising, and to devise some means of bringing the machine to the attention of consumers so that general distribution of the new product could be started immediately after the Christmas season.

COMMENTARY: Although the company's primary purpose of effecting substantial economies by smoothing out its aggregate sales curve was not an issue in this case, it is to be noted that the company should not have expected to achieve that purpose by the course adopted. The seasonal fluctuations in the sales of phonographs, to be sure, were not likely to coincide with those of the sales of building materials. An appreciable gain from that diversification, however, could have resulted only if the new line of merchandise was sold by the same sales organization which sold the other items that the company imported. Because the phonographs would have been sold to a class of customers entirely different from those which bought building materials and railway materials, with the employment of different merchandising methods, a segregated sales organization would have been essential.[3] With a segregated sales organization, the operating expenses of one sales division would not have been affected appreciably by fluctuations in the sales of the other division.

The Etoile was a high-price novelty. That should have been the primary consideration in the determination of the methods of retail and wholesale distribution. Even though the machine might develop even-

[3] See Tinkham, Littell, Incorporated, 1 H.B.R. 352; commentary, 2 H.B.R. 507; American Locomotive Company, 3 H.B.R. 149.

tually into a permanent specialty, the safest plan of procedure at the outset was to merchandise it as a high-price novelty. The problems of merchandising the Etoile as a high-price novelty were similar in several respects to those of merchandising a fad,[4] but because of the difference in price between this phonograph and an article such as colored jute twine, for example, the danger of cut-throat price competition among retailers was far more serious for the phonograph than for the twine.

Since the phonograph was a novelty, initial distribution should have been sought in prominent metropolitan department stores or other aggressive retail establishments, and an exclusive agency should have been granted to one store in each large city for one year. A year would have been a sufficiently long period for the initial exploitation of such a novelty by a large metropolitan store, and before the expiration of that period experience could have been accumulated to indicate the future course to be followed. After the arrangements had been completed for placing the Etoile in the metropolitan stores, similar arrangements should have been made expeditiously with high-grade department stores, music stores, or sporting goods stores in smaller cities.

In order to make sure that the proper retail stores were selected, the company probably would have had to sell directly to retailers, at least until such time as the novelty had worn off and the little phonograph had become an article of staple merchandise sold widely in music stores, hardware stores, and drug stores, as well as in department stores.

As for a fad, rapid initial distribution was desirable for this high-price novelty, starting with prominent metropolitan stores, whose example would be followed eagerly by retailers in other cities. To guard against ruinous price-cutting, however, the company should have restricted the sales privileges, at least during the first year, to a single store in each city. Under such a plan the active assistance of the retailers could have been enlisted for promptly exploiting the novelty.

Since economy in purchase, or price, was not the chief consumer buying motive to stress, but rather the novelty, entertainment, attractiveness as a gift, dependability, and handiness of the Etoile, the suggestions for cheapening the machine by lowering the quality of the materials used in its manufacture do not deserve serious consideration.

The retail selling price apparently should have been \$29. The cost landed in New York, duty paid, was \$14. To this was to be added the importer's selling cost and profit and the retailer's gross margin. The importer's selling cost probably would have been as great as the margin demanded by wholesalers, 10% of the retail price. The importers desired a net profit of at least 10% of the wholesale price. For retailers under the plan proposed, a gross margin of 35% would have been

[4] See Cardiff Manufacturing Company, page 94.

adequate. With a retail margin of 35%, the estimated selling expense of the importer (10% of the retail price) would have been 15.4% of the wholesale price $\left(\frac{10\%}{100\%-35\%}=15.4\%\right)$. Thus, allowing for a net profit of 10% of the wholesale price, the importer's gross margin would have been 25.4% of the wholesale price (15.4%+10%). Since the cost was \$14, it was necessary for the selling price to be at least \$18.77 to cover this margin $\left(\frac{\$14}{100\%-25.4\%}=\$18.77\right)$. With a wholesale price of \$18.77, the retail price would have to be at least \$28.88 to yield a gross margin of 35% to the retailers $\left(\frac{\$18.77}{100\%-35\%}=\$28.88\right)$. This indicates that the retail price should have been approximately \$29, a figure to be preferred from the merchandising standpoint to a round price of \$30. The price suggested here is tentative, of course, subject to modification if new facts affecting the price were developed during the introductory negotiations.

The point of special significance in this case is the advantage of rapid exploitation of a novelty, starting strategically with prominent stores in the large metropolitan markets.

March, 1926 M. T. C.

Clermont Company[1]

MANUFACTURER—HOSIERY

Distribution Channels—*Retailers Utilized in Preference to Wholesalers.* In May, 1922, because of business depression, wholesalers who previously had placed orders with this hosiery manufacturing company several months in advance of dates of delivery were unwilling to place contracts as usual. The company, therefore, made inquiries regarding the conditions under which it could secure orders for its products directly from resident buyers and cooperative buying associations of department stores. It learned that if it adopted such a policy of direct sale it would have to accept the stipulations of the individual stores as to terms of purchase, punctuality in delivery, and private brands.

(1922)

In May, 1922, inasmuch as the wholesalers who previously had contracted for the major portion of its output were unwilling to make substantial future commitments, the Clermont Company contemplated selling its products directly to retailers. The company operated two mills in New Jersey for the manufacture of hosiery and maintained a sales office in New York City. One wholesaler was ready to contract for the entire output of the Clermont Company, but the company was reluctant to take the risk of becoming wholly dependent on a single customer.

Although its products were more nearly staple than those of silk hosiery manufacturers who specialized on fancy designs, the Clermont Company did not make up goods for stock. The Clermont Company contracted for its raw material from three to six months in advance. The proportion of raw material cost to total cost was high enough to cause price changes in the finished product when fluctuations occurred in raw material prices. Wholesalers normally contracted early in the fall for silk hosiery, mostly under the wholesalers' private brands, to be delivered to them during the winter and in turn shipped to retailers during the spring months. Again in the spring, wholesalers contracted for hosiery to be shipped to them in July and August and delivered to retail stores during the months from September to December.

[1] Fictitious name.

In manufacturing hosiery for shipment to wholesalers, the Clermont Company usually made up a large lot of each color and size. This scale of operation yielded substantial economies to the manufacturer; for instance, it cost little more to dye 100 dozen pairs than to dye 30 dozen pairs; and there were other similar economies. In selling to wholesalers, it was not necessary for the Clermont Company to carry a stock of finished goods; the products were shipped as soon as manufactured. Inasmuch as wholesalers carried stocks, occasional delays in shipment, necessitated by contingencies arising during the process of manufacture, seldom caused serious embarrassment to the manufacturer or inconvenience to the wholesale customers.

At its sales office the Clermont Company maintained a small sales force to call on wholesalers. In changing its distribution policy, the company did not wish to undertake the development of a traveling sales force to call on retail stores. The possibility was considered, therefore, of selling to New York resident buyers and to the New York buying offices of department store buying associations.

Several groups of department stores situated in cities at a distance from the New York primary market had formed associations for the purpose of maintaining permanent buying offices in New York City. In one or two instances, associations of department stores which originally were formed for the purpose of comparing data on operating expenses had developed at least partially into buying associations.

In such lines of merchandise as women's ready-to-wear garments, resident buyers operating offices in New York City on their own account had built up a clientele among small department stores outside New York. A typical resident buyer entered into contracts with several department stores to supply them with merchandise in the lines on which the buyer specialized, making a charge for his services of 3% of the cost of the goods to the firms. Through his established relations with manufacturers and because of the large quantities of merchandise which he was able to sell for them, such a resident buyer claimed that he ordinarily secured substantial discounts from the prices which these manufacturers quoted directly to the individual stores. Since merchandise purchased through a resident buyer frequently was delivered

to the retail store before a buyer or merchandise manager of the store had had an opportunity to see the goods or inspect samples, it was necessary for the resident buyer to arrange for liberal return privileges with manufacturers.

In addition to the sales to resident buyers and buying associations, the Clermont Company expected that orders would be obtained from department store buyers who visited the New York selling office. If at any time the Clermont Company wished to dispose of merchandise, when demand from department stores was not active, it was planned to utilize the services of local agents in various cities. These local agents customarily sold several non-competing lines of merchandise on a commission basis, and usually manufacturers who expected to use these agents as an outlet in times of slack demand found it advisable to allot them at least a small quantity of merchandise for sale at other times, even when demand was brisk. By selling the bulk of its output to department store buying associations and resident buyers, the Clermont Company estimated that its selling expenses at least would be no greater than when it sold entirely to wholesalers.

The United Mercantile Buying Association[2] had a membership of 14 department stores and metropolitan specialty stores in New England and central and western New York, no two of which were situated in the same city. The annual volume of sales of these stores ranged from $1,300,000 for the smallest store to $4,800,000 for the largest store. The members of the association exchanged figures with each other for purposes of comparison. The association also maintained a buying office on Fifth Avenue in New York. This office was utilized by several departments of the stores in placing orders for as much as 35% or 40% of their requirements, and by others to a smaller extent. In all cases, deliveries were made to individual stores, and the association assumed no credit responsibility. Four stores in the association had developed their own brands on numerous articles of apparel; several carried well-known, nationally advertised brands of wearing apparel; and all sold unbranded merchandise. Policies in regard to securing cash discounts differed in the individual stores.

In each of these stores buying plans were under the close control of one or more merchandise managers, who carefully super-

[2] Fictitious name.

vised the work of the department buyers. The stores in this group all placed special emphasis on rapidity of stock-turn. Merchandise buying plans, therefore, usually were made up on a monthly rather than on a seasonal basis. In buying from manufacturers, the stores in this association placed large orders at the beginning of a season, deliveries to be made at specified times and in specified quantities and assortments during the season. Punctual delivery on the dates specified was essential, since merchandise on order frequently was advertised for sale before it was received. Several of the stores regarded delivery later than date promised as an adequate reason for returning merchandise to manufacturers.

After merchandise managers of several of the stores had had an opportunity to inspect its hosiery, the manager of the New York buying office of the United Mercantile Buying Association entered into negotiations with the Clermont Company to buy 90% of its output for the fall season of 1922. At first the association demanded the same price that wholesalers had paid. Later, the New York buying office was authorized to offer 5% more. Policies of the individual stores were to be followed as regards terms, deliveries, returns, and brands. It was understood that if relations proved satisfactory, the arrangement was to be continued indefinitely, but a contract was not to be made for a period longer than one season.

COMMENTARY: This problem was precipitated by the reluctance of wholesalers to assume inventory risks during the period of price readjustment which followed the crisis of 1920. Previously the wholesalers had placed orders far enough in advance of the opening of each season to permit the economical planning of production in the factory. The wholesalers had performed the functions of carrying seasonal stocks of merchandise, with the risks imposed thereby, as well as the functions of effecting sales to retailers and of assuming credit risks.

By securing orders directly from resident buyers or cooperative buying associations, the company could have avoided the necessity of employing a large sales force or of assuming promiscuous credit risks. It could not have avoided inventory risks, however, if it continued to operate its factory as theretofore. Although the stores which placed orders through these agencies might have given large orders at the opening of the seasons, those orders would not have been placed so far

in advance as commonly had been done by the wholesalers. The stores, furthermore, required monthly deliveries and this would have necessitated changes in the company's production methods in order to insure punctuality in delivery. The demands of the individual stores for private brands and special discount arrangements also would have meant a new burden for the company. These extra risks and expenses would have made it necessary for the company, in order to show a profit, to charge higher prices on merchandise sold to resident buyers and cooperative buying associations than on sales to wholesalers; it is doubtful if the 5% differential offered would have been sufficient to cover the additional expenses.

Under these circumstances, no net gain could have been counted on immediately by the company in shifting from wholesalers to resident buyers and cooperative buying associations. The decision should not have been based upon the abnormal conditions that existed in 1922 but upon the permanent prospects. The company apparently did not have data at hand to show whether discontinuance of sales to wholesalers would be desirable as a permanent policy. If any shift were to have been made, a well-coordinated program of sales promotion should have been mapped out and the production and financial plans of the company should have been harmonized with that program.

November, 1925 M. T. C.

Rockburn Company[1]

DEPARTMENTIZED SPECIALTY STORE—HOSIERY

PURCHASING—*Special-Order Merchandise Obtained by Group Buying.* The company, a departmentized specialty store, desired to arrange for the purchase of silk hosiery of special quality to be sold at a predetermined price. The store was a member of a group buying association and by placing its plans before other members of the group it succeeded in arranging for a sufficiently large order to induce a manufacturer to undertake the production of the hosiery at an acceptable price.

(1925)

The Rockburn Company was a member of a group buying association composed of 22 department and specialty stores located in different cities. One of the essential features of the model stock plan which the Rockburn Company was following was a BB or "best buy." By "best buy" was meant merchandise which was of greater intrinsic value than any similar merchandise which could be purchased at a comparable price at any other store in the city in which the company was located. Because of competition between the retail stores of the city, it was difficult for a store to establish and maintain a BB; the Rockburn Company, however, wished especially to obtain such an article for its women's silk hosiery department for the fall selling season of 1925.

The Rockburn Company's store was located in the center of the retail shopping area of a large southern city. This company, which sold the better grades of popular-price merchandise, gave careful attention to the interior appearance of its store as well as to the service rendered to its customers. The net sales for the store were about $15,000,000 a year. Of these sales, 57% were made for cash, 39% were made on charge accounts, and 4% were made for collection on delivery.

The women's silk hosiery department, with annual net sales of $350,000, was located on the street floor between two of the four largest entrances to the store. Sales in this department were made chiefly in five price lines: $1.00, $1.50, $1.75, $2.00, and $2.25. Some hosiery was sold in the department for more

[1] Fictitious name.

than $2.25 per pair, but full assortments of this hosiery were not carried. A full assortment consisted of 5 sizes and about 25 colors and shades.

The average original mark-up in the department was about 32% of the original retail price. The average gross margin, exclusive of cash discounts, obtained in the department during the year 1924 had been 25% of net sales, with total expenses of 26% of net sales. The store followed the practice of loading its discounts to 9% of cost prices. The buyer in charge of this department operated under the direction of a divisional merchandise manager, who also supervised several other departments on the street floor.

It was the opinion of the divisional merchandise manager of the Rockburn Company's store that, because of the increasing competition among the retail stores of the city, the plan of offering "best buys" presented several difficulties. The development of competition had caused the stores in the city to shop with more care the merchandise offered by their competitors. Thus, when one store established a BB, its competitors soon learned this fact and sought to duplicate the merchandise at the same price. If they succeeded, the merchandise ceased to be the best buy in the city and a new BB for that line of merchandise had to be found. Such changes caused a rapid shifting of BB's in a department, with the result that some stock was left over from each BB when a change was made. Thus, in time, a large proportion of the stock in a department would be made up of former BB's. Since the margin of profit on a BB usually was limited, this gradual accumulation tended to decrease the profitableness of the department.

In order to establish a BB of merit, a store had to be connected with a source of supply able to produce better or cheaper merchandise than its competitors, or the store had to have a style monopoly which other stores could not obtain. It also was necessary for the buyer to work closely with the manufacturer from whom the goods were purchased, because frequently a buyer would not see the possibilities for a BB in a casual inspection of a manufacturer's line of merchandise. It usually was only when a buyer or a divisional merchandise manager worked closely with a manufacturer on styles or volume that he discovered a unique

article or an article which could be sold in sufficient volume to enable him to obtain a price especially attractive to the customers of the store. Even in such a case, it was necessary that the store have the good-will and complete cooperation of the manufacturer in order to make the project successful and to maintain any advantages gained.

The customers of the Rockburn Company's store frequently complained that the feet of the stockings which they purchased in the store wore out more quickly than the other parts of the stockings. If the store could discover a special process for making the feet of its hosiery wear better, without raising the price of the stockings, it would have a BB for that line.

The buyer for the silk hosiery department and the divisional merchandise manager decided to attempt to establish a BB in one full line of hosiery to sell for $2 a pair. The stockings sold at $2 in the department at that time were full-fashioned, pure dye, lisle top and foot, silk stockings which were carried in the usual range of sizes and colors. If a special processing for the feet of those stockings could be developed by the manufacturer, the divisional merchandise manager believed the wearing qualities of the stockings would be improved. He estimated that, if the store could obtain a type of longer wearing stocking to sell at the regular, advertised price of $2, it could sell 6,000 dozen pairs per year.

After considerable research, the divisional merchandise manager estimated that a mill whose production schedule was so arranged that it could make the special hosiery for the store would charge $1 per dozen more than the usual price to the store of the hosiery then retailed at $2. At that time, this hosiery cost the store $16 a dozen at the mill. Seventy-five per cent of the increase in cost would be due to the actual increase in cost of the materials and of the process to the manufacturer, and the remaining 25% would be remuneration for changing the machines and making new production schedules, and for the risks taken in experimenting with the new line.

It would be necessary for any mill undertaking the work to operate at least one set of machines for the special type hosiery. A set of machines in a hosiery mill consisted of three leggers and one footer. One set of machines produced approximately 1,000 dozen pairs of stockings per month.

If a mill which would produce this type of hosiery could be found, it would be necessary to market somehow the 6,000 dozen pairs of stockings above the estimated requirements of the Rockburn Company. The retail price of these stockings, to yield the same profit as the stockings then sold at $2 in the store, would have to be over $2.08. If this type of hosiery were sold at $2 a pair, the store would obtain no net profit, and the next full-line price of $2.25 would be too high. The store did not wish to establish an intermediate price line if that could be avoided.

The Rockburn Company might suggest to the other stores of the group buying association of which it was a member that they participate in the purchase of this line of hosiery. If a sufficient volume of orders was obtained, the Rockburn Company might be able to secure a lower price per dozen from the manufacturer. In the different stores which were members of the buying group, the general conditions, the type of merchandise sold, the size and type of stocks carried, and the advertising policies differed widely. The divisional merchandise manager estimated that, at the most, only three stores in the association would buy as much hosiery of this type and price as would the Rockburn Company, but that several of the other stores in the group might take smaller amounts. He estimated that it probably would be possible for the entire group to absorb the total output of 4 sets of machines, or 48,000 dozen pairs of stockings annually.

It was possible that the hosiery buyers for the different member stores would oppose group buying for their departments; they might look upon such buying as a restriction of their own powers or they might not believe that merchandise purchased in that way could be sold as readily in their departments as merchandise which they personally purchased. It might be difficult to obtain a sufficient quantity of the hosiery at the desired price from a mill. If a mill were producing regularly at capacity, it probably would not care to change part of its machines in order to experiment on the new feature hosiery. If a suitable mill with four sets of idle machines could be found, the association, by giving the mill orders which would bring its production up to capacity and thus reduce the rate of the overhead expense per unit, probably would be able to persuade the mill to sell the hosiery at a lower price than that estimated by the divisional merchandise manager

of the Rockburn Company. Although the divisional merchandise manager did not know of such a mill, he thought that one could be found.

As soon as a stocking of this special type was offered for sale by the stores in the association, it was possible that other stores, groups of stores, or manufacturers of hosiery, would duplicate the new stocking at the same price; in that case, the exclusive advantage of the long-wearing foot in hosiery at the usual price would be lost.

The store decided to try to persuade the group buying association to undertake this plan. Thus, if successful, the Rockburn Company would have the advantage of a satisfactory "best buy" obtainable, because of quantity purchasing, at lower prices than any individual store could secure. At the same time, the article would be sold in each city exclusively by one store. The association adopted the plan and discovered a manufacturer in the exact situation needed. The hosiery was purchased at $16 a dozen, and later the association succeeded in getting it at $15.50 a dozen.

COMMENTARY: The success of the group buying plan in this instance arose primarily from the assumption of initiative by the Rockburn Company in devising means for improving the quality of the merchandise which it sold. Its own purchases were not large enough to enable the store alone to enter into satisfactory arrangements with a manufacturer for the production of the goods. For the success of the plan it was necessary not only that the improvements in quality be effected but also that the price be kept sufficiently low and that competitors should not be able immediately to buy the same kind of goods. The arrangements effected through the group buying association made possible the securing of the desired product on satisfactory terms with adequate temporary protection.

July, 1926 M. T. C.

Wechsler Company[1]

WHOLESALER—CANNED VEGETABLES

PURCHASING—*Storage Expenses for Futures Assumed by Manufacturer.* The company, a wholesale grocery firm, customarily contracted for a nine months' supply of canned corn and peas each spring for delivery in the fall, following the close of the canning season. In the spring of 1925 the company made an arrangement with a packer whereby the company's nine months' requirements of canned corn and peas were to be delivered throughout the nine months in lots as needed by the company, payment to be made when invoices were received. Under this arrangement the company's storage, interest, and insurance charges were substantially less than under the previous plan.

(1925)

The Wechsler Company had a private brand, under which a large part of its high-grade canned goods was sold. The president believed that the net profit obtained on the canned goods was reduced materially by the carrying charges incurred in purchasing the customary nine months' supply at one time.

The company had annual sales of approximately $1,000,000. Its 2,000 customers were located within a radius of 250 miles. Customers in the city in which the company was located were called upon as frequently as twice a week. Some customers in the more distant territories were visited only once a month. The company employed 20 salesmen. Those in the local territories received, as commission, 33⅓% of the gross margin on their sales; and those in the outlying territories received 40% of their gross margins. The company sold a complete line of medium-price and high-price groceries. The storage space in the company's main office and warehouse building was inadequate for the peak inventories of canned goods; each fall it was necessary to obtain additional space in public warehouses.

Prior to 1925 the president of the Wechsler Company had purchased futures for canned goods when approached by the representatives of the canners in the spring of the year. The merchandise contracted for at this time had been delivered during August, September, and October of the same year. No guar-

[1] Fictitious name.

anty against possible price changes was given the wholesaler by the canner; fixed prices were contained in the contract. Merchandise was to be paid for at the time of its delivery. The Wechsler Company made no allowance to retailers if prices declined after sales were made. The company expected these futures contracts to provide a nine months' supply. Immediately after contracting for the canned goods, the company sold futures to its retail customers. Ordinarily, from one-third to one-half of all futures purchases were disposed of in this way. The merchandise thus sold was delivered to the retailers immediately after its receipt by the company. Additional space in public warehouses was secured for the remainder of the canned goods. This merchandise was removed from the warehouses as sales were made to retailers.

In the spring of 1924, the company had purchased a total of 9,000 cases of canned peas and corn. These vegetables, which all had been received in stock by November 30, 1924, had been purchased from a large canner located in the Middle West from whom the company had been purchasing for about five years. The canning company not only contracted with farmers for their crops of peas and corn, but also owned nearly 4,000 acres of land on which it produced these crops. Relations with this canner always had been entirely satisfactory to the Wechsler Company. The quality of the merchandise had been of the best, and the canning company never had failed to abide by any of its agreements.

The president of the Wechsler Company sought to obtain an average gross margin of 15% upon sales of canned peas and canned corn. The gross margin obtained on some other lines of merchandise was as low as 5%. Operating expenses for the company, including interest on owned capital, had equaled 10% of sales, in 1924. The cost of storage on peas and corn had been 2½ cents per case for the first month, and 1½ cents per case each month thereafter. The insurance rate per annum had been ¾ of 1% of the value of the merchandise stored.

Early in 1925, the company was visited by the representative of the canner of peas and corn from whom it customarily had purchased. The representative sought the contract for these vegetables and, as in the past, expected to deliver them in the

fall of 1925. The president of the Wechsler Company believed that the prices which were quoted to him were as low as could be obtained from any other canner for merchandise of similar quality. He told the representative, however, that purchases of canned goods would be made only on condition that the merchandise be delivered in lots as needed by the Wechsler Company, rather than all at one time. It was the intention of the president to have delivered in the fall of 1925 only enough canned peas and corn to fill the orders for futures which had been sold to the retail grocers and to provide the company with the merchandise necessary to fill any replacement orders that might be received.

The president of the Wechsler Company stated that the custom of delivering the entire quantity of canned goods in the fall of the year had been established largely because many of the canners did not have sufficient capital and credit to permit them to carry the merchandise in stock until it was desired by wholesalers. Wholesalers, furthermore, had believed the customary plan necessary in order to secure a high quality of merchandise to be sold under their private brands.

As competition between canners had become keener, several canners who could command sufficient financial resources had offered to deliver merchandise in lots of various sizes throughout the late fall and winter rather than in one lot immediately after the canning season. The wholesaler was not expected to make payment for the merchandise until it was received. This tendency had gradually increased until a few strong canners offered to ship the merchandise in lots as needed by the wholesale grocers. In the president's opinion, the canner from whom he purchased peas and corn was sufficiently strong financially to store the merchandise until it was desired by the Wechsler Company. The canner's representative accepted the president's condition in regard to the delivery of merchandise, and the company placed an order with him for 9,000 cases of canned vegetables.

In previous years, when all the canned goods had been delivered at one time, the company's private label had been placed upon the merchandise before it was shipped by the canner. When sales had not materialized as the company had expected, it had been difficult to sell the merchandise to competing whole-

sale grocers, because the competitors had to remove the private label of the Wechsler Company and to relabel the cans with their own private labels. The cost of making such a change of labels was 5 to 10 cents a dozen cans. The agreement made in 1925, however, provided that the merchandise was not to be labeled until it was ordered for delivery to the Wechsler Company. Thus, if sales were not so large as anticipated, it would be less difficult to sell a portion of the merchandise to competitors, as either the canner's label or the competitor's label could be placed on the merchandise before shipment.

In the opinion of the president, the company was not sacrificing quality or taking any undue risk of not receiving the quality of merchandise which it desired. The contract specified that the highest grade of merchandise was to be packed for the Wechsler Company. The president felt assured from the canner's action in the past that this quality of merchandise would be delivered. He demonstrated still further his confidence in the packer. The terms of the canner specified that a discount of 2% would be allowed the Wechsler Company, provided the invoices were paid immediately upon their receipt. If the company waited until the merchandise arrived before paying the invoices, a discount of only 1½% would be given. Although the latter provision permitted the company to inspect the merchandise, the company intended to take the 2% discount throughout 1925.

Another condition existed which also assured the president that the quality of merchandise which he desired would be delivered. He said that because of the apparent profits which had been made by farmers in selling peas and corn to the canners, there had been an increasing tendency for farmers, especially those in the Middle West, to increase their production of these vegetables. It was his opinion that this increase in production had exceeded the increase in consumption with the result that a high quality of peas or corn could be obtained at any time throughout the year. He knew that this had been the situation with peas throughout 1924; although it had not been true of corn, the shortage in the latter product had been the result of a poor corn crop in 1924.

Another advantage was obtained by the Wechsler Company by the change in the time of delivery of the canned peas and corn.

For several years the company had invested all the surplus funds which it had in the spring and summer months of each year in railroad equipment trust certificates. These securities ordinarily had yielded from 5½% to 7% interest. It had been the policy of the company to sell these securities from October to December or in the early months of the following year as it became necessary to obtain funds to pay for the large quantities of merchandise received in stock during that period. Often the company had borrowed money upon its lines of credit while it still owned the equipment certificates. During 1924, 4% interest had been paid upon such borrowings, while from 5½% to 6% had been obtained from the equipment certificates. In the fall of 1925, however, the company would not have so much capital and credit invested in canned goods and, hence, could purchase additional equipment certificates; it would not be necessary, furthermore, to liquidate all those securities purchased during the spring and summer of 1925.

In April, 1925, the president of the Wechsler Company estimated the saving in carrying charges which would result from the more rapid rate of stock-turn on futures to be obtained in 1925 and 1926. The sale of futures to retailers had not been so large as in former years. It was estimated that such sales, plus the amount which would be necessary for stock, would not equal more than 33⅓% of purchases.

The experience of the company in the past had been that the unsold stocks of canned goods which had to be placed in public warehouses in November did not decrease greatly, if at all, during December and January. This was because almost all retailers had purchased sufficient merchandise to supply their needs during these two months. The company did not have available records which showed the rate at which these stocks had decreased in former years following December and January. For purposes of calculation, however, the company estimated that an equal quantity would be sold each month, and that the entire quantity would be sold at the end of nine months. Thus, monthly sales in the last seven months of the nine months' period would equal 857 cases. The actual gains would vary from the estimate to the same extent that sales varied from those used in the calculation.

The president considered that, although the interest charged by the bank was only 4%, the saving in interest should be calculated on the basis of 6% since that was the rate charged, according to the company's accounting procedure, on owned capital at the end of the year. The calculations did not include any possible income to be received from the purchase of railroad equipment certificates. The average cost value per case of merchandise purchased had been \$3.75. The estimated savings were as follows:

Storage		
6,000 cases for one month at 2 cents a case	\$120	
6,000 cases for one month at 1½ cents a case	90	
6,000 cases decreasing uniformly at the rate of 857 cases a month over 7 months,[2] at 1½ cents a case	270	\$ 480
Interest		
6,000 cases at \$3.75 a case for two months	\$225	
6,000 cases at \$3.75 a case decreasing uniformly at the rate of 857 cases a month over 7 months[3]	338	563
Insurance		
6,000 cases at \$3.75 a case for two months	\$ 28	
6,000 cases at \$3.75 a case decreasing uniformly at the rate of 857 cases a month over 7 months[3]	42	70
Total saving		\$1,113

Because the company would carry in stock only about one month's supply, or a carload, of the items which the canner had agreed to carry until needed, it was certain that the company's rate of stock-turn in those items would be increased substantially.

COMMENTARY: The trade put through by the Wechsler Company, whereby the canning company agreed to carry the merchandise in stock after the conclusion of the canning season, to be delivered in accordance with the wholesale grocery company's instructions, obviously yielded a gain to the Wechsler Company. So far as this particular transaction

[2] During the ninth month no storage charges were to be paid because the merchandise would be removed to the company building at the end of the eighth month.

[3] Since the month's supply of merchandise which remained at the end of the eighth month would be used as the reserve supply, which was kept in the company warehouse to meet current demands, and for which interest and insurance charges were borne consistently by the company, charges for these items for the ninth month were not included in the calculations.

was concerned, there is nothing in the evidence to show that it was other than an ordinary trading arrangement.

Such a procedure as this, however, may have significant implications from a broad view-point and, perhaps, may give a clue to possible future developments in this industry. Heretofore, the canning companies generally have been small, with meagre capital. Their plant operations have been highly seasonal and they usually have not maintained sales organizations. Their sales have been made in advance of production, not uncommonly with the aid of brokers. Under such circumstances the wholesale grocers have performed an essential service in placing advance orders and in carrying large seasonal stocks. Because of the strength of the wholesalers' position and their services in merchandising and in carrying seasonal stocks, the use of wholesalers' private brands developed rather naturally in this trade.

But when a wholesale firm, such as the Wechsler Company, arranged for a canning company to carry the stock of goods, unlabeled, until ordered out by the wholesaler, the wholesaler shifted one of his major functions to the canner.[4] It is stated that the canner's price was as low as that of competitors who produced goods of similar quality. In addition to quoting so low a price, the canner took over the burden of carrying the goods. After the canner had made this concession, many of the advantages which he had obtained by the previous methods of packing the goods under the wholesaler's private label disappeared, and it would not have been a long step for the canner in a subsequent year to have undertaken to sell goods under his own trade-mark. The advantages cited for holding goods unlabeled, in order to avoid the expense of relabeling when an overstock was sold to a competitor, suggest a gain that might accrue to the canning company if all its goods bore its label rather than wholesalers' private brands.

The canning industry is so highly seasonal that it has been assumed generally that the stock-carrying function ordinarily could be performed more economically by wholesale grocers, after the close of the canning season, than by canners. The opportunity to perform this service, consequently, has been a real element of strength in the wholesale grocers' position. If a canning company is induced to accede to several bargains of the type described in this case, it will not be strange if the

[4] In other cases on record wholesale grocery firms have tried to keep their stocks of canned goods futures at a minimum by restricting their purchases of futures and by endeavoring to pass their futures purchases on to their retail customers as soon as possible. See the cases of the Broderick Company and the Bethel Company, Bureau of Business Research, Harvard University, Bulletin No. 55, *Cases on Merchandise Control in the Wholesale Grocery Business*, pp. 18 and 189.

canning company decides to rely less heavily on the wholesale grocers' services in the future, perhaps by seeking to establish its own trademark.

As an isolated instance, this bargain has little significance. If it be typical, it suggests a weakening of the position of the wholesale grocer, as a result primarily of his own action.

May, 1926 M. T. C.

California Fruit Growers' Exchange

COOPERATIVE MARKETING ASSOCIATION—FRUIT

Brand Development—*Consumer Advertising as Means of.* By extensive advertising a cooperative marketing association formed by California citrus-fruit growers developed a brand under which fruit of the best quality was sold. Advertising of this brand was expected to extend the uses of the fruits sold under it, to establish a preference for California citrus fruits, to extend markets, promote reasonable profits, and encourage sound merchandising methods in the trade.

Consumer Demand—*Expansibility of Market Contrasted with Elasticity of Demand—(Commentary).* By means of advertising and other methods of sales promotion, the California Fruit Growers' Exchange succeeded in increasing materially the demand for citrus fruits, thereby demonstrating that the market for those fruits was expansible. Previous reductions in prices had failed to stimulate sales, thereby indicating that the demand was not elastic.

(1925)

The California Fruit Growers' Exchange, a cooperative marketing association, was organized in 1905 as successor to the Southern California Fruit Exchange[1], which had been organized in 1893 as a federation of smaller associations. The development of these marketing organizations received strong impetus from the conditions in the industry and in the citrus fruit market, which had brought prices for the fruit to ruinously low figures. In order to stimulate sales, the association decided in 1907 to enter upon an advertising program.

The members of the local associations affiliated with the California Fruit Growers' Exchange were fruit growers. Each local association assembled the fruit in its packing house, and graded, packed, and prepared the fruit for shipment. Several associations picked the fruit for their members. It was a common practice for each local association to pool the shipments of its members, sell the fruit without maintaining the identity of the shipments of each individual grower, and divide the proceeds from the sale pro rata. Such pools usually were on a monthly basis.

[1] MacCurdy, Rahno Mabel, *The History of the California Fruit Growers' Exchange,* 1925, pp. 51-52.

The membership in the local associations was voluntary and only for one year. Every grower reserved the right to regulate and control his own shipments, develop his own brands, and use his own judgment as to how and when his fruit should be shipped, to which markets, and what prices he would accept. As a matter of practice, however, the growers were influenced largely by the advice of the central exchange.

The local associations were grouped into 22 district exchanges which acted as clearing-houses and which were operated on a non-profit plan. These district exchanges kept records of shipments and destinations and obtained reports concerning market conditions from the central exchange. Through the central exchange instructions were issued regarding prices and destinations and for the diversion of cars and trains in transit in order that the fruit might be sent to the most favorable markets. Although only a small percentage of the total shipments actually were diverted in transit, those diversions preserved the balance of the market.

The chief markets for California citrus fruits were in the cities in the middle-western and eastern United States. The fruit was shipped in trainloads on regular schedules. Shipments were made daily throughout the year. Refrigerator cars were used, and precooling stations had been established in order to facilitate the proper regulation of temperature for shipments. The central exchange acted as a clearing-house for the district exchanges. It had representatives in all the important markets in the country from whom advice constantly was received regarding market conditions and prices. The fruit was sold for cash, and payment was made through the central exchange. The exchange also collected claims for damage and loss in transit. The proportion of fruit shipped through this exchange increased steadily.

There were several significant reasons for the development of this cooperative organization. In the first place, at the time the movement gained headway most rapidly, there was dissatisfaction among the growers over their relations with buyers, commission merchants, and others to whom their fruit was sold. Their product was increasing in quantity, and prices were falling. Gluts frequently occurred in the markets to which the fruit was sent. The blame for low prices and losses commonly was placed upon the middlemen. The growers found that they could obtain lower

EXHIBIT 1

ANNUAL SALES OF ORANGES, GRAPEFRUIT, AND LEMONS BY CALIFORNIA FRUIT GROWERS' EXCHANGE AND ITS PREDECESSOR*

(Value f.o.b. cars in California)

Season Ending†	Sales Value	Cars	Season Ending†	Sales Value	Cars
1896	$ 1,032,212	2,487	1911	$20,708,355	28,123
1897	858,029	1,789	1912	17,235,822	23,648
1898	1,671,230	4,025	1913	13,640,091	12,432
1899	1,713,514	3,000	1914	18,990,725	28,186
1900	3,643,791	6,039	1915	19,523,397	29,812
1901	4,799,000	11,027	1916	27,675,922	29,828
1902	4,385,472	7,309	1917	33,478,130	36,219
1903	4,497,919	9,621	1918	36,291,675	19,214
1904	5,062,594	13,072	1919	54,627,556	33,165
1905	7,124,377	14,219	1920	58,967,388	34,461
1906	9,936,497	12,884	1921	56,905,876	40,959
1907	12,268,752	16,217	1922	48,445,644	27,138
1908	11,753,544	17,636	1923	55,271,975	45,258
1909	13,958,990	22,954	1924	50,508,184	44,266
1910	14,831,975	19,639	1925	70,236,507	37,258

*MacCurdy, Rahno Mabel, *History of the California Fruit Growers' Exchange*, 1925, p. 70, supplemented by data for 1925 from the *Annual Report of the General Manager of the California Fruit Growers' Exchange* for that year.

†Exchange fiscal years ended August 31 to season 1920-1921 and October 31 thereafter.

freight rates, faster time in transit, and less damage to their fruit if they were in a position to contract with the railroad companies for the regular shipment of trainloads. The growers also had been gaining experience in united action through their irrigation projects and through the need for cooperation in the protection of their orchards. The citrus-fruit growing industry in California was specialized and required large capital.

After entering upon its advertising program, the California Fruit Growers' Exchange developed the Sunkist brand of citrus fruits. Only such fruit as was of first quality was permitted to bear this brand. Shipments that were not up to the standard were sold under other brands or unbranded. This brand was one of the chief means that the exchange used for developing the demand for the products of its members.

The increase in the volume of sales of oranges, grapefruit, and lemons by the Southern California Fruit Exchange and its successor, the California Fruit Growers' Exchange, in the period

from 1896 to 1925, is indicated by the statistics in Exhibit 1. This record covers 11 years preceding and 19 years following the inauguration of the advertising plan.

In the annual reports of the general manager of the exchange data have been published on the selling and advertising expense. Systematic advertising by the exchange was commenced in 1907, with an appropriation of $10,000 by the board of directors. In the following year the appropriation was increased to $25,000.[2] In 1925 the total advertising expenditures of the exchange amounted to approximately $830,000, at the rate of 4½ cents per box of oranges and grapefruit and 7 cents per box of lemons.[3] The annual ratios of the total selling and advertising expense to the delivered value of the sales, 1905 to 1925, are stated in Exhibit 2. The figures for sales in Exhibit 1 were for value f.o.b. cars in California, but the delivered value, which included transportation costs, was used by the exchange in computing the ratios in Exhibit 2.

---

[2] MacCurdy, Rahno Mabel, *History of the California Fruit Growers' Exchange,* 1925, pp. 59-64.

[3] One view of the effect of advertising on fruit prices and the costs of production was expressed in the following letter, published in *Printers' Ink,* August 17, 1922, written in response to a contributor's question as to why the prices of nationally advertised fruits were so high.

THE DURANT CORPORATION

Yakima, Washington, August 7, 1922

Editor of *Printers' Ink:*

In the issue of *Printers' Ink* as of July 27, 1922, F. M. Berkley asks a question regarding the price of variously advertised brands of apples and oranges which I will try to answer.

For the past 12 years I have been closely related to the growing and marketing of Northwestern apples. While I am not familiar with oranges in the same light that I am with apples, the conditions surrounding the production of this commodity are, I believe, somewhat similar to the production of apples.

The cooperative growers of California have, by consistent national advertising, created a demand which has likewise increased the sale of their products, thereby creating a market for the large increased production.

Profiting from the experience of the California growers, the Northwestern growers have, within the past few years, appropriated large sums to the advertising of the Northwest boxed apple, the "Big Y" and Skookum brands being living testimonials of these past efforts.

The money for these various appropriations has been assessed directly against the grower at so much per box, in some cases as high as 5 cents a box. The cost of raising, warehousing, and loading a box of apples to the grower is in the neighborhood of $1.15, which cost is based on quantity production and cannot be reduced through increased sales. Commission houses charge from 10 to 15 cents selling charge, plus in some cases 2 or 3 cents brokerage.

Now add 5 cents for advertising appropriation and even though the advertising does increase the sales, which it is expected to do, it *has not cut the cost of production,* and has added 5 cents to the selling cost. So Mr. Berkley will readily see that the advertising of apples or oranges cannot reduce the retail price, but is resorted to to create a demand for the ever-increased production of these commodities.

We also have some keen competition in the eastern barreled apple, which we are trying to overcome by educational advertising of boxed apples, which tells the consumer that every apple is hand-picked and packed. Each apple is wrapped in tissue paper to insure good keeping qualities and sanitation to the consumer; also every apple is graded and inspected, and nothing but the fruit of the very highest grade is allowed to pass our rigid inspection rules.

No, Mr. Berkley, the advertising of apples will never reduce selling cost to the grower, but on the other hand, adds to it.

H. L. CRAVER.

EXHIBIT 2

SELLING AND ADVERTISING EXPENSE OF CALIFORNIA FRUIT GROWERS' EXCHANGE, IN PERCENTAGE OF DELIVERED VALUE OF GOODS SOLD*

Year Ending	Selling and Advertising Expense	Year Ending	Selling and Advertising Expense
1905	3.28%	1916	3.14%
1906	2.89	1917	3.01
1907	2.65	1918	1.79
1908	3.05	1919	1.62
1909	3.44	1920	2.01
1910	3.57	1921	2.32
1911	3.25	1922	1.69
1912	3.53	1923	2.49
1913	2.62	1924	3.04
1914	3.31	1925	2.40
1915	3.72		

*Compiled from the *Annual Reports of the General Manager of the California Fruit Growers' Exchange.*

The expenses of the exchange were stated in the annual report of the general manager for the year ending August 31, 1919, to have been as follows:

The sales service of the exchange cost an average of 4.26 cents per box in 1918-19, and that of the district exchanges averaged .94 cents a box, making a total average cost for the exchange marketing service of 5.2 cents per box, or 1.04% of the delivered value. In addition there was invested in advertising, 2½ cents a box for oranges and 4 cents a box for lemons, making the total sales and advertising expense 1.62% of the delivered value of the fruit. Due to the increased volume of business handled, the exchange selling cost, including advertising, is lower than it was 10 years ago and lower than the marketing cost of any other perishable food product in America.[4]

The following statements were made in the annual report of the general manager of the California Fruit Growers' Exchange for the year ending October 31, 1922:

The total shipments of oranges and grapefruit from California, as reported by the railroads, for the year ended October 31, 1922, were 29,573 carloads, and of lemons 9,926 carloads, or a total of 39,499 carloads. The members of the exchange shipped during the same period 18,578 cars of oranges and grapefruit, and 8,560 cars of lemons, making

[4] *Annual Report of the General Manager of the California Fruit Growers' Exchange for the Year Closing August 31, 1919,* p. 4.

an aggregate of 27,138 cars, or 68.7% of the citrus fruit shipments from the state. The exchange handled 72.5% of the crop the previous year; its membership is steadily increasing and the smaller percentage this season is due to the fact that the fruit damage was most severe in the districts where it is most strongly represented.

Exchange shipments for the past season, expressed in terms of boxes, were 7,952,284¼ boxes of oranges, 168,796 boxes of grapefruit, and 3,496,222¾ boxes of lemons.

Estimating the value of the cars yet unsold, the returns for exchange shipments, f.o.b. cars California, for the year ended October 31, 1922, were $48,647,800.25, the delivered value in the markets being $65,367,127.65. For the season's citrus crop, based on exchange results, California received $71,366,464.50, the delivered value being $95,993,-485.58, which includes $24,627,021.08 for freight and refrigeration.

. . . .

Exclusive of advertising, the entire service of the central exchange cost an average of 7.7 cents per box for the year ended October 31, 1922. Immediately following the freeze, the force and expenses were reduced to the minimum compatible with conserving the efficiency of the organization for the sale of the fruit to be shipped, but with the smaller volume the per box cost is higher than in other recent years.

The average cost of the service rendered by the district exchanges during the same period was 1.8 cents per box, making the total average operating cost 9.5 cents per box, or 1.69% of the delivered value of the fruit and 2.27% of the f.o.b. returns.

. . . .

The estimate of January 1 indicated a crop for the season of nearly 15,000 cars—an increase of 3,000 cars over the previous year and 6,000 cars over 1920. The estimated California crop was in excess of the combined supply of California and imported lemons in any previous year. The total supply of lemons in the United States in 1920-21 was 13,903 cars, and the year before 13,251 cars. Two years ago, the California crop as a whole sold at a loss, and it was only the unusually hot summer in 1921 that allowed the average price for that season to be above the cost of production.

Because the principal lemon acreage[5] is in the districts where the

[5] The present bearing lemon area in California comprises 33,000 acres, which are now producing more than the normal consumption of the United States and Canada. The 17,000 acres of non-bearing trees, if properly cared for, will create a supply greatly in excess of present demands. The exchange growers, having this condition in mind, have for a number of years used educational advertising intensively to inform the public of the many valuable and delicious uses for lemons; they are working with the trade toward better displays, lower margins and more rapid turnover, and are studying in detail market possibilities, developing new markets where practicable, and are endeavoring to put lemons in all the markets in the best condition possible. During the past season several new markets have been opened, largely in territories previously supplied with foreign lemons. *Annual Report of the General Manager of the California Fruit Growers' Exchange, October 31, 1921,* p. 13.

temperatures were not so severe and a larger proportion of it was protected by orchard-heating devices, the lemon crop suffered less than the orange crop by the freeze in January. The fruit picked after the freeze amounted to 64% of the quantity originally estimated to be picked from that date.

The prices of lemons, when compared with other years, were not materially affected by the freeze because, due to the increased crop, the shipments from California were greater after that time than in any other year, excepting 1919 and 1921, and the importations of Italian lemons were increased. However, it is questionable whether the entire crop, with the addition of normal imports, could have been marketed to advantage, considering the high cost of its production.

. . . .

The demand for lemons is increasing, due to the continuous publicity calling the attention of the public to the many ways in which they may be used to advantage in the household; due to the development of the lemonade demand, and to a better and more regular distribution. The markets absorbed a heavier supply during the winter and spring months than ever before at good prices, and the average for the season has been satisfactory, with practically a maximum supply compared with other years and with no unusually favorable weather conditions in the consuming sections.

It is true, however, that except for the frost damage California would have produced this year considerably more lemons than the United States and Canada have ever consumed, and the most intensive work to further develop the markets and increase the per capita consumption is necessary to successfully market prospective future crops. Lemon trees are more susceptible to damage than orange trees, due to their more vigorous growth in the winter months, and next season's production will be more seriously affected by the freeze of last January than in the case of oranges. Nevertheless, the prospects are for a greater quantity than was shipped this year, and the rapid recovery of the groves indicates a production in 1924 of as large a crop as California has ever shipped and an increasing one thereafter.

. . . .

The first purpose of Sunkist advertising is to increase the total use of oranges and lemons, and the second to create and increase the consumer and trade preference for California citrus fruits, particularly the Sunkist brand. The third objective is to extend markets and promote reasonable margins, good displays, and sound merchandising methods with the trade.

In revising the season's advertising plan on a short crop basis to keep the expenditure within the appropriation of 3½ cents per box on oranges and 6 cents per box on lemons, the educational features of Sunkist advertising were kept predominant. Emphasis was placed on the health value of citrus fruits, the place of these wholesome fruits

in the well-balanced diet and especially the necessity of orange juice for infant feeding.

. . . .

California citrus fruit growers must be mindful of the constantly increasing competition from other fruits, the acreage of which is being rapidly extended, of the advertising of these fruits and of other food products, and continue their advertising on a scale which will keep oranges and lemons in the enviable position which they now occupy with the public, and extend their use.[6]

The following statements are excerpts from the annual report of the general manager of the exchange for 1925:

The season 1924-25 has seen the greatest returns to California for the citrus fruit crop of any year in the history of the industry. Based upon exchange results the total crop has returned to California $93,-581,263.71. The delivered value of the crop was $122,245,523.99, including approximately $28,664,260.28 for freight and refrigeration.

This result was obtained on a reduced volume of fruit due to a severe freeze which occurred December 25, 26, and 27. The total citrus fruit shipments reported by the railroads for the year ended October 31, 1925, were 49,437 carloads, compared with 60,732 carloads the previous year. The orange and grapefruit shipments were 37,679 carloads and the lemon shipments 11,758 carloads.

The exchange handled 75.4% of the total crop, or 37,258 carloads, returning to California $70,236,507.02, compared with $50,508,184.53 the preceding year when 44,266 carloads were shipped through it.

The exchange volume was 16% less than that of last year and the returns, f.o.b. cars California, 39% more. Figured back to the tree, the returns to the growers were over three-quarters greater than those of last year.

The returns last year were not satisfactory, but comparing results with those of 1922-23, when the volume was practically the same and the returns normal, the returns, f.o.b. cars California, were 27% greater and for the fruit on the tree 41% greater this year.

Expressed in terms of boxes, exchange shipments equaled 11,967,715 of oranges and grapefruit and 4,176,677 of lemons.

. . . .

Exclusive of advertising, the cost of the California Fruit Growers' Exchange service was 6.87 cents a box for the season 1924-25.

The cost of the district exchange service averages 1.59 cents per box, which brings the total average operating cost to 8.46 cents per box. This represents 1.49% of the delivered value of the fruit marketed and 1.94% of the f.o.b. returns. The smaller volume this year resulted in a higher per-box cost than usual. The operating cost of

[6] *Annual Report of the General Manager of the California Fruit Growers' Exchange for the Year Ended October 31, 1922*, pp. 7, 8, 12, 14, and 15.

the exchange in normal years has been about 5.5 cents per box. In addition 4½ cents per box of oranges and 7 cents per box of lemons was expended in national advertising and dealer service work, making an average cost for both marketing and advertising of 2.4% of the delivered value of the fruit.

. . . .

Advertising is a form of education and, like education, the work is never finished. The American market of 120 million people is a changing one, changing as to individuals and as to habits and customs of the people. It requires sustained effort, as well as alertness to opportunity, to maintain and increase public preference for a food product. The exchange has recognized both necessities.

Millions of favorable and convincing impressions have been delivered to the American public through the exchange advertising campaign of 1925. Recipes and use suggestions which delineate attractive ways of using oranges and lemons have been presented to the public, reinforced by sound information on the health value of citrus fruits. Scientific evidence is accumulating on every hand to further establish citrus fruits as outstanding in health attributes among fruits. The medical profession, research workers and the forces of public education are unanimous in urging a liberal consumption of fruit as a measure of general healthfulness. This situation affords the citrus industry an exceptional opportunity to tie its own advertising efforts closely to this public program. This has been done by the exchange, which has also been instrumental in initiating several specialized investigations by competent authorities to establish additional health evidence.

Such a policy of sound and helpful education affords the exchange an unusual entree with teachers and public institutions. As an instance, Sunkist bulletins numbering 1,821,000 were distributed to domestic science teachers and federal extension workers this year. These bulletins were ordered by the teachers and used for classroom instruction. In the same manner 83,000 dietetic bulletins were distributed to nurse training schools. These bulletins outline the health value of citrus fruits in the diet and go to those who are students of the subject and are passed on to the millions they advise.

No marketing plan can reach the full measure of success without the intelligent and complete cooperation of the trade. There are approximately half a million retail outlets for citrus fruits. This vast army of distributors is vital to the successful marketing of the citrus crop. Adequate stocks, good display, reasonable margins and rapid turnover are necessary factors in proper distribution. The exchange dealer service program, which represents 25% of the annual advertising investment, deals with these things.

Dealer service men working in the marketing centers carry the messages of better merchandising to thousands of dealers annually, 45,000 being the number personally visited this season; 28,000 Sunkist and Red Ball sales windows were installed, 10,000 calls were made on

Sunkist extractor owners in the interest of stimulating the sale of orangeade and lemonade at soda fountains and of improving the quality of these drinks served. Letters aggregating 146,153 were mailed to the trade, supplementing this personal service. The chief value of the work is its cumulative effect. It has been a part of the exchange advertising plan for ten years. It is designed to furnish object lessons of the resultfulness of good display and reasonable margins and to serve as a clearing house for progressive sales ideas. This work further serves to increase the effectiveness of other forms of exchange advertising.

Commercial orangeade and lemonade are now substantial factors in citrus fruit demand and furnish the most promising sources of additional demand. The exchange is largely responsible for developing this new market, and its growth is a matter of only four years. Citrus fruit consumption at soda fountains was relatively insignificant until the Sunkist electric juice extractor was perfected in 1922. Approximately 7,000 of these machines were sold this season, bringing the total now in use to 27,000. At the rate of a box of citrus fruit a week, which is conservative as a year-round average per machine, these Sunkist extractors are directly responsible for a fruit consumption of 1,350,000 boxes this season. This represents new business of approximately 3,400 carloads. Every eight Sunkist extractors which can be placed in service create a new market for an extra carload of oranges and lemons.

In the furtherance of this program the exchange is operating a model store on the board walk of Atlantic City, serving fresh fruit lemonade and orangeade on the "See-it-made" principle. The store has served more than a quarter-million customers since its opening in April. For equipment the store employs a special Sunkist fountain unit which is admirably adapted to rapid and cleanly service. The object is to demonstrate to the fountain operators and concessionaires the soundness of serving a pure fruit drink in place of the synthetic and fortified preparations which have taken advantage of the orange and lemonade desire of the public.

The exploitation of fresh fruit orangeade and lemonade is important, not alone because of the amount of citrus fruit directly consumed in this way. Even more significant is the sampling and reminder through displays in prominent locations which serve to keep oranges and lemons constantly and conspicuously before the people.[7]

Commentary: The experience of this organization illustrates the difference between expansibility of market and elasticity of demand. By the use of advertising and other active sales promotion methods the market for citrus fruits was greatly expanded without continuous reductions in price. The market yielded to the pressure of the sales methods adopted; it was expansible. There may be some degree of

[7] *Annual Report of the General Manager of the California Fruit Growers' Exchange, October 31, 1925,* pp. 5, 7, 8, 14, 15, and 16.

elasticity to the demand for citrus fruits—that is, the demand may be influenced by price changes; nevertheless, the industry could not have prospered if it had relied on reductions in price to dispose of its crops. One of the chief reasons for the formation of the cooperative organization, indeed, was the fact that prices received by the growers had been below production costs for several years, and the volume of sales had not increased readily in response to reductions in prices.

In reviewing the experience of the cooperative organization, we must recognize that changes in general business conditions have affected the industry. The Southern California Fruit Exchange was formed during a period of general business depression, and its subsequent prosperity was attained partly because of the improvement in general business conditions. The methods adopted for grading, pooling, and shipping fruit played a large part in the attainment of success by the cooperative society. After making allowance for these factors, however, the fact remains that the market was expanded by merchandising methods which stimulated wider and wider demand rather than by price reductions.

Although the amount spent for advertising became large in the aggregate, it was but a small fraction of the selling price of the fruit. The total advertising appropriation in 1925 was about $830,000, at the rate of 4½ cents per box of oranges and 7 cents per box of lemons shipped by the exchange. It is inconceivable that a reduction in price of 4½ cents per box of oranges and 7 cents per box of lemons would have stimulated demand as greatly as it was stimulated by the advertising program of the exchange.

May, 1926 M. T. C.

Menton Company[1]

WHOLESALER—GROCERIES

Advertising—*Change from Newspaper and Street-Car Cards to Direct Mail and Personal Canvassing.* Sales of merchandise under its own brand constituted a large part of the annual sales of the company, a wholesale grocery firm. In 1924 the company undertook an advertising program which called for the use of newspapers and street-car cards in its territory. For the following year, the company decided to utilize direct-mail circulars, household canvassing, and various other means of sales promotion in preference to newspapers and street-car cards.

Brand Development—*Advertising by Wholesaler to Consumer.* In 1917 the company, a wholesale grocery firm, began to sell merchandise under its private brand. At the outset, the company did not advertise the merchandise bearing its brand, but in 1923 it advertised in newspapers and street-cars within its territory and the following year modified its sales promotion plans to utilize direct-mail circulars, personal canvassing, and other means of stimulating demand from consumers.

(1924)

Practically all the canned goods, bottled goods, coffee and tea, and some of the cereals sold by the Menton Company, a wholesale grocery firm, bore the company's private brand. In the latter part of 1924, in an attempt to create a greater consumer demand for the Menton products and to increase sales in the more profitable lines, the company installed a sales promotion department.

The Menton Company was situated in a middle-western city with a population of about 2,000,000. With few exceptions, the company's customers were located within a radius of 20 miles; all merchandise was delivered by the company in its own trucks.

The annual net sales, which consisted of medium-price, non-perishable merchandise, were about $1,900,000. The annual rate of stock-turn was about 8 times, and net profit, after deduction of interest on owned capital, was 3% of sales. The company employed 16 salesmen, paying them 33⅓% of the gross margin on their sales. With the exception of coffee-roasting and tea-

[1] Fictitious name.

packing, the company did no manufacturing. Inventories and purchases were not departmentized.

The Menton Company first sold merchandise under its private brand in 1917. Merchandise under this brand was of a distinctly higher grade than the corresponding merchandise previously sold. The company did not advertise the private brand while introducing it. In the latter part of 1923, however, the company began to advertise this brand in local daily newspapers and in street-cars. During the next 12 months the company spent $8,000 for such advertising. In 1924 the company was making from 30% to 40% of its sales under the Menton brand.

In the fall of 1924 the president of the Menton Company concluded that the newspaper and street-car advertising was not effective in reaching the public. The advertising never had stimulated a measurable increase in the volume of sales of any particular item. The president discontinued this advertising, therefore, and established a sales promotion department. He placed in charge of the department one of the company's salesmen who had had experience in the retail grocery trade. This manager had from one to four assistants. The assistants were about 20 years of age and were selected because of their alertness and ability as salesmen. The salary paid an assistant was $20 a week.

The sales promotion department asked the company's retail customers for the names of those consumers who were most likely to become purchasers of Menton products. Although at first a few of the retail grocers were reluctant to comply with the request, they cooperated fully when they understood the company's policy. In all, 119 retail grocers supplied a list of 9,800 names. These names the promotion department used as a mailing list and also as a basis for personal solicitation by the members of the department. The company distributed monthly to each of the 9,800 consumers a folder describing the merchandise sold under the Menton brand. The folders, about 7 inches by 10 inches in size, were printed in two colors on a high grade of heavy paper. On the front of each folder appeared the address of a consumer and the name and the return address of the retail grocer who had supplied the consumer's name. On the back of the folder there was a slogan designed to attract the customer's attention. For example, the words *Lenten Menu—Tasty Food for Particular*

Folks appeared on the folder mailed at the beginning of the Lenten season.

On the inside of each folder and at the top of the page, from four to six of the company's products were pictured in an attractive manner. Selected recipes suggesting methods of serving the products displayed were given beneath the pictures. The Lenten folder, for example, advertised salmon, crab meat, lobster, tuna fish, sardines, and macaroni. The accompanying recipes were for salmon croquettes, crab-meat cutlets, lobster salad, and macaroni and cheese. The company learned that housewives often kept these folders because of the recipes. The cost of distributing the folders, including printing, addressing, and stamps, was about $300 per month.

Members of the sales promotion department personally solicited orders from the prospective customers whose names the retail grocers had supplied. Each representative carried a sample case which contained from six to eight items, and, whenever possible, he gave the consumer an opportunity to sample the merchandise. The representative then solicited orders, which were to be filled by the retail grocer who had supplied the name of the purchaser. The salesman who customarily called upon the retailer received a commission for the subsequent sale which the Menton Company made.

The company estimated that the representatives could make demonstrations to three out of every six women called upon and sales to one or two of the three. Frequently women who refused to purchase from a representative would go to a retail grocer within a short time and purchase the product from him.

The sales promotion department used another method of acquainting the public with the company's merchandise. This was the serving of luncheons and dinners free of charge to church and social organizations. The arrangements differed with each instance. Ordinarily, the Menton Company supplied all the vegetables needed for the luncheon or dinner; the retail grocer most closely associated with the organization supplied the meat; and the organization itself furnished ice-cream. Members of the organization prepared the meal. In one instance of a dinner served to 150 people the total cost to the company was only $30. In some cases, before the Menton Company agreed to supply the

luncheon or dinner, the members of the association were required to sell a specific quantity of merchandise for the retail grocer who was to participate in the plan.

One important benefit which the company derived from the work of the sales promotion department was the stimulation of the sale of products which previously had been slow moving. Sales of canned crab meat, for example, had not been satisfactory. At one dinner the company served crab-meat cutlets, the recipe for which was printed in the "Lenten Menu" folder. As a result, sales of the company's crab meat increased to such an extent that a week before Easter none of this product remained in stock. At the beginning of 1924 the company had purchased 1,000 cases of another product. This merchandise had remained in stock for a year; the company finally had disposed of it at a loss. The company was confident, however, that with adequate sales effort it could sell this item profitably, and, consequently, placed a new order for the item. Through the efforts of the sales promotion department the company sold 318 cases of this item at a profit during the first four months of 1925. The company expected repeat orders to be satisfactory. In the future the company intended to make even greater efforts to create new uses for slow-moving merchandise which it had in stock.

The company obtained through its sales promotion department an increase in sales to the retail grocers for whom the promotion work was done. For example, a representative in three days had sold $107 worth of merchandise for one grocer. The grocer had increased the size of his purchase from $107 to $350 at retail prices. In another instance, a retail grocer had intended to go out of business because of competition from chain stores. The Menton Company had pointed out to him that no grocer in the community was selling high-grade merchandise and had urged him to stock the Menton line exclusively. The company's representative had sold $210 worth of merchandise for the grocer. In a period of two weeks, immediately preceding and following the campaign, the grocer had purchased $700 worth of merchandise from the company.

The sales promotion department also assisted the company in obtaining new customers. In one instance, a man who was opening a new retail grocery store offered to purchase from $1,200 to

$1,500 worth of merchandise from the Menton Company if it would do sales promotion work in his territory. The request was granted; the work of the sales promotion department was satisfactory; and the company obtained the order.

In the course of its sales promotion work, the department had an opportunity to ascertain what products consumers desired. In 1924, for example, the company had sold 100 cases of chili sauce in 16-ounce bottles at 35 cents retail and 200 cases in 8-ounce bottles at 20 cents retail. The sales promotion department learned that consumers preferred to purchase chili sauce in 12-ounce bottles rather than in either the 8-ounce or 16-ounce bottles, which were the only sizes then sold by the company. The company contracted with a canner to supply 800 cases of 12-ounce bottles at a price which permitted the product to retail at 25 cents a bottle. In the first few months of 1925, the sales of 12-ounce bottles of chili sauce were such that the company was certain that it would dispose of the 800 cases in 1925. Sales of this product had been increased partially through the efforts of the sales promotion department in demonstrating and distributing a recipe by which Russian dressing could be made with Menton chili sauce.

Several other advantages were obtained by the company as a result of its sales promotion department. The department proved to be an excellent means of training salesmen. The young men who were experienced as representatives in the department could be substituted satisfactorily, when needed, for salesmen.

The department also had adjusted the complaints of both consumers and retail grocers. In one instance, a retailer who had decided to discontinue the sale of Menton products because of a disagreement with the credit manager had been reconciled to the company through the efforts of the sales promotion department. Another retail grocer had wished to return merchandise which he stated he could not sell. The sales promotion department succeeded in creating a demand for the product among his customers, with the result that repeat orders for this merchandise were received from the grocer.

Commentary: The first point of significance in this case is the recognition by the wholesale grocery firm that it must assume a burden of

sales promotion in order to strengthen its private brand. It was necessary for the company, if the private brand was to attain real significance, to interest consumers in that brand. Although this burden involved extra expense, it was a clearcut means of stimulating sales in the more profitable lines.[2] The Menton Company by its policy undertook to move the merchandise out of the retail stores, not merely to place it on the retailers' shelves.

The second point of significance in this case is the decision of the company to substitute direct circularizing and household canvassing for newspaper and street-car advertising. The company clearly was experimenting with different methods of promotion and the enthusiasm which it manifested for its latest venture does not prove that it would find adherence to the new plan advisable after the novelty had worn off. The use of circulars which were mailed directly to consumers made possible the use of typographical and pictorial methods that were not available for newspaper advertising. In these circulars, it also was practical to state the message at greater length than in the newspapers and especially than in street-car cards. In doing this, the company could offer recipes to housewives and thereby strengthen the buying motives for its products. The direct-mail and personal canvassing methods also reached the homes of consumers and could be addressed to selected consumers who might be expected to convey to their friends and neighbors their appreciation of Menton products. In carrying out this program, however, the number of consumers reached would be much smaller than the number of newspaper readers and street-car passengers. In order to hold patronage, the experience of other advertisers would indicate that continuous circularizing probably would be necessary. As the mailing list became longer, the cost would increase very likely to a point where it would exceed the 1.2% of sales of private brand merchandise which the company had spent for newspaper and street-car advertising in 1924.

The use of the direct-mail and personal canvassing methods, furthermore, had a disadvantage for such merchandise as this in tending to tie down the distribution to too few retailers. The success of the company in securing the cooperation of selected retailers was likely to cause apathy on the part of other retailers and thus to restrict distribution; yet the company's products fell into the class of convenience goods for which it was desirable to have as dense distribution as possible. The use of canvassing methods, furthermore, for merchandise on which the unit of sale was so small as for most grocery items was likely to become prohibitively costly when carried out on a substantial

[2] See also, in this connection, Cleland Company, page 191, and Pulitzer Company, page 180.

scale. The furnishing of materials for church dinners is an old scheme which has been looked upon with less and less favor by merchants in many communities. There is doubt as to its effectiveness in stimulating demand for particular brands, and it is difficult to avoid abuses of the practice without arousing enmity among solicitous promoters who assume the attitude that if the company furnishes materials for one charitable enterprise it should treat them similarly.

The company apparently was meeting with success in its methods of sales promotion. It was quite likely, however, that further experimentation would be necessary before the final solution of the company's merchandising problem was found.

November, 1925 M. T. C.

Bigelow Furniture Company[1]

MANUFACTURER—FURNITURE

Aggressive Selling—*Active Solicitation of Orders.* The company manufactured high-grade furniture upon special orders only. It had developed its sales volume with little direct sales effort, depending upon the excellence of its work and its reputation to bring interior decorators, architects, and other customers to it. The company had one salesman and two representatives who visited comparatively few customers or potential customers. It was proposed that the company employ additional salesmen to solicit orders actively.

(1922)

The Bigelow Furniture Company manufactured solely upon special orders. It was a long-established firm, and, in 1922, was one of the largest producers of special-order furniture in the United States. Its sales volume had increased gradually with little direct sales effort; sales in 1921 were approximately $350,000. The company reproduced any piece or suite of furniture desired by customers and was prepared to design suites to harmonize with any specified chair, table, or other piece. Many of the desks, chairs, and tables which the company manufactured required carving, and much of the panel work required artistic painting. The company had sold several pieces for more than $2,000 apiece, and a large number of pieces for several hundred dollars each. Hinges and other metal parts requiring special work were made at the company's plant. The company employed six designers and eight skilled workmen who made carvings from original designs as well as replicas of figures appearing in pieces of foreign furniture. All painting on the furniture was done by hand.

In 1922 the executives of the company were considering the advisability of employing additional salesmen to solicit orders from interior decorators and from retailers selling high-grade furniture. Practically every year, for a long period, the company had obtained a single order amounting to from $100,000 to $200,000, so that with the small orders it received it had been

[1] Fictitious name.

able to maintain a satisfactory volume of operations. Since the company could not be sure of continuing to receive a large order each year, the executives were of the opinion that the company should plan to obtain adequate sales independently of any extremely large orders which might be received.

In the 10 years from 1890 to 1900 the Bigelow Furniture Company had sent pieces produced at its plant to the furniture exhibitions held in Grand Rapids, Michigan. The company had been, in fact, one of the first companies to send furniture from outside of Grand Rapids to the exhibitions held there.[2] In 1900, however, the company had concluded that few buyers who were interested in special-order furniture attended the exhibitions, and that the business which the company obtained by taking part in the exhibitions was not sufficient to warrant the cost.

After deciding not to continue to take part in the Grand Rapids exhibitions, the Bigelow Furniture Company had employed two salesmen for several years. Those salesmen had traveled throughout the country, calling chiefly on interior decorators. The company finally had decided that this sales effort was unnecessary, on the ground that the interior decorators who placed orders with the company would do so without the solicitation of salesmen.

In 1922 the company had an office and display room in New York City in which it exhibited several thousand dollars worth of the finest pieces of furniture that it had manufactured. That office was in charge of a salesman who was also an able designer. He had many photographs and drawings showing the work done by the company. He himself designed furniture for customers and was so busy consulting with interior decorators, architects, and owners of large estates that he had time in the course of a year to call on but 10 or 12 of the numerous interior decorators in New York City.

In Chicago, the company had a representative who worked on a commission basis. He also represented several other companies selling supplies to interior decorators. In California, the company had a representative who made one sales trip a year, visiting the principal interior decorators of Washington, Idaho, Oregon, and California. That man also represented several companies.

[2] See Touraine Company, page 56.

Sales to high-class hotels were a substantial part of the Bigelow Furniture Company's business. Hotels in Baltimore, Washington, New York City, Chicago, San Francisco, and other large cities had purchased their lobby, ballroom, and reception room furniture from the company. The company had obtained those orders with little sales effort. The first few hotel orders had been obtained from the interior decorators who were in charge of the work of furnishing the hotels, but since then the managers of other hotels had come directly to the company. The contract departments of several large department stores in New York City and Philadelphia secured much of their furniture for decorating hotels, clubs, and large residences from the company.

Several interior decorators located in different sections of the United States, who took contracts for the decoration of only one or two large residences, a hotel, or a club during the course of a year, customarily bought their furniture from the Bigelow Furniture Company. In some instances, the company contracted with the interior decorators, but generally it contracted directly with the persons who were having the decorative work done. The company's terms of sale were 2% for cash in 10 days, net 30 days.

The company did not plan to keep furniture in stock or to build furniture of standard designs, even if it increased its sales volume by employing additional salesmen to visit interior decorators and retailers. The company would continue to manufacture upon special orders only. However, if enough orders were received for furniture of the same type, it might be feasible for the company to adopt some of the manufacturing methods used by companies producing large quantities of furniture for stock.

The Bigelow Furniture Company, however, did not want to make any changes which would alter the type of work done in its plant. The plant was equipped to do special-order work and the employees were skilled in that type of work. Many of the employees had been with the company for 20, 30, or 40 years. The company was unwilling to manufacture on a quantity basis. For these reasons, the management recognized that it might be inadvisable to increase the cost of selling by employing additional salesmen. The number of customers who could afford to purchase the grade of furniture which the company manufactured was comparatively small.

Commentary: This case furnishes an example of a business in which intensive solicitation of orders and avoidance of a high degree of concentration of orders were not desirable practices.

The company was carrying out consistently a policy of producing furniture on special orders for customers who desired to manifest a highly individualized expression of artistic taste. These customers did not desire standardized furniture, however artistic it might be in itself, because it was not distinctive and because it was not likely to blend fully with the other furnishings in the rooms in which it was to be placed. The demand for special-order furniture, such as the company produced, was sporadic, appearing at scattered sources without regularity as to time or frequency. Under these circumstances, for the company to have attempted to solicit orders intensively not only would have been wasteful, because of the sporadic character of the demand, but might have endangered its prestige with that group of consumers who desired to manifest highly individualized tastes. The Bigelow Furniture Company was catering to consumers whose demands were even more highly specialized than were the demands of consumers of the type to which the Touraine Company's[3] products were sold. The Bigelow Furniture Company's clientele represented the extreme of exclusiveness in demand.

The company's representatives, it is judged, were maintaining friendly personal relationships with the few interior decorators and architects who were most likely to have occasion to name Bigelow furniture in their specifications. Attempts to become intimately acquainted with a much larger number of decorators and architects probably would not have been worth the cost.

The experience of the company that a single large order constituted a substantial part of its sales each year was a ground for apprehension in so far as there was a chance that some year no such order would be secured. On the other hand, much of the company's prestige must have accrued from the association of its name with these large orders. The more large orders the company filled satisfactorily, the more it was likely to receive, because of the continual enhancement of its reputation. It must be remembered, moreover, that all the company's orders were special orders. This company was in a merchandising position that was altogether different from that of a company manufacturing standardized products for which a constant flow must be maintained through predetermined trade channels. For the Bigelow Furniture Company, when an opportunity to secure a large order appeared, there was no likelihood that its acceptance would imperil relationships with other customers, because there was little continuity to those relation-

[3] See page 56.

ships. Aside from changes in general business conditions, there were no reasons for the company to apprehend increasing difficulties in continuing to secure large contracts of the type which it was equipped to fulfil.

The company was following a sound policy in seeking large individual orders and in not utilizing generally intensive methods of sales promotion.

March, 1926 M. T. C.

Moody & Wells Lumber Company[1]

WHOLESALER—YELLOW PINE

Aggressive Selling—*Active Solicitation of Orders.* The company, a wholesale firm selling yellow pine to retailers and contractors, employed but one salesman, who visited customers at infrequent intervals in order to have some acquaintance with their requirements. It was suggested that the company should solicit orders actively, as was being done by steel and cement companies, which, it was asserted, had extended the use of steel and cement at the expense of the use of yellow pine. The company decided, however, that the nature of its market was such that sales could not be increased appreciably by aggressive sales methods.

(1922)

The Moody & Wells Lumber Company, a wholesale firm which sold yellow pine to retailers and also directly to contractors, had not followed a practice of conducting vigorous sales campaigns or of sending out salesmen to stimulate a demand for its products. The company's one salesman visited the permanent customers at infrequent intervals in order to have some acquaintance with their requirements. The rest of his time he spent in the office or in the yard supervising the filling of orders or making adjustments with customers. A majority of the officers of the company were convinced that it was impossible for a large wholesale lumber company to increase its sales of lumber appreciably by sending out salesmen. These officers averred that a salesman could not convince any one who did not intend to buy lumber that it was desirable for him to do so; they contended that lumber was purchased on the basis of price, quality, and service. The general manager of the company summarized the position of these executives in the following statement:

Our retail customers stock spruce but do not stock yellow pine because of the large number of sizes which would have to be carried in stock and the large amount of money which would have to be tied up in the stock. When they desire yellow pine to fill an order from a contractor or other buyer, they submit their schedule for bids to the various yellow pine wholesalers in the vicinity. It would make no difference to them in the placing of their orders whether our salesman had called on them in the last day or two, as their decision as to who shall obtain the

[1] Fictitious name.

order will be made on the basis of price and any opinion which they may have obtained from previous experience regarding the relative quality of the timbers and service furnished by the various wholesalers. The same situation exists in the case of contractors and others who buy directly from us. They may want yellow pine timbers only once or twice a year, and it is impossible for us to tell when they will need them. If their order is of any size, they will submit a schedule to our competitors and the contract will be awarded on the basis of the bids submitted. If a man is not planning to use yellow pine timbers for his work, I do not feel that any amount of sales effort will make him change his plans.

Certain members of the management group disagreed with this point of view and, in 1922, recommended that the company adopt an aggressive sales policy. They pointed out that it was the practice of steel and cement companies to keep salesmen constantly on the road and asserted that these salesmen had succeeded in extending the use of steel and cement at the expense of the use of yellow pine. Many retail lumber yards, said these officers, had been persuaded to stock cement. One of the executives stated that the selling problems of lumber wholesalers were similar to the selling problems of manufacturers of textile and other mill machinery, and that those manufacturers employed salesmen to stimulate sales of their products. This executive said further:

It seems to me that a demand for lumber can be stimulated just as well as a demand for concrete or steel. It may not be possible to convince a man that he should build, but it should be possible to convince him that when he does build he should use lumber instead of concrete and steel construction. It, also, should be possible to convince him that it is to his advantage to buy from you rather than from one of your competitors, especially if the competitor does not also have salesmen out.

The Moody & Wells Lumber Company, however, decided not to change its sales policy.

Commentary: This case presents arguments pro and con on a controversial question. The company apparently had no specific evidence to substantiate either one view or the other. The analogy with textile and other mill machinery cited is not conclusive, for such machinery is sold usually to known prospective customers and technical points must be explained by a representative of the seller before a sale is consummated. The lumber company did not have an equally definite group of prospective customers to approach nor was its product highly

technical. The analogy with steel and cement may hold good, or it may not; the evidence is not yet available to prove that point.

The lumber which the company was selling was of standard grade. Its qualities were known to contractors and retailers. Other potential buyers, who were contemplating the erection of buildings, could have been located by the company only with difficulty before their building plans were announced. At that stage the plans, in many instances, could not have been influenced by a lumber company's salesmen. Under these circumstances there were strong reasons for doubting the probable success of a sales plan which envisaged the active solicitation of orders by a crew of salesmen.

May, 1926 M. T. C.

American Locomotive Company

MANUFACTURER—LOCOMOTIVES AND AUTOMOBILES

Sales Organization—*Segregation by Lines of Products—(Commentary).* The company, which manufactured locomotives, began also to manufacture and market motor trucks and passenger automobiles. The company's venture in the automobile business was said to be unsuccessful. Because of the differences in the nature of the markets for locomotives, motor trucks, and passenger automobiles, the company should have segregated its sales organization by lines of products.

(1913)

In 1906 the American Locomotive Company, one of the two companies that manufactured a large proportion of the steam locomotives produced in the United States, began to manufacture and sell passenger automobiles and automobile trucks.[1] The company acquired the American rights to the French Berliet car. The company built a large factory in Providence, Rhode Island, and invested $6,000,000 in this enterprise. The automobiles were mechanically successful and sold at high prices. In 1913 the company was said to rank third in the United States in the manufacture of commercial motor vehicles. It was further stated that the company had established service stations in Long Island City and in San Francisco, and headquarters and branch offices in New York City, Chicago, Boston, and Philadelphia. For the first 3 or 4 years after entering the automobile industry, the company sold its automobiles entirely through 4 retail branches. During the next 4 years, the company granted 89 agencies.

In August, 1913, the company announced its withdrawal from the manufacture and sale of automobiles and motor trucks. The venture was said to have been commercially unsuccessful. While the location of the factory possibly was disadvantageous, the major difficulty appeared to have been in the sales methods used. When the announcement was made of the company's discontinuance of the automobile business, it was stated that the company had not realized, at least not until too late, that quite different methods were required for the marketing of automobiles and for the marketing of locomotives.

[1] *Printers' Ink,* August 28, 1913, pp. 82, 83.

COMMENTARY: This case illustrates that there are differences of vital consequence in the proper methods of marketing locomotives and automobiles. After engaging in the manufacture of automobiles, the company had markets of three types. The first of these was its old market for locomotives. Locomotives constituted an item of major equipment for purchasers and therefore fell into the class of merchandise which may be designated as installations. The market for locomotives was narrowly defined and the purchasers had technical knowledge of their requirements and of the equipment which the company was offering for sale. The individual orders received by the manufacturer of this equipment were large; sales were made directly to the users; and only a small sales organization was required.

The second type of market was for motor trucks. Motor trucks, like locomotives, were industrial goods, but belonged in the class of accessory equipment instead of in the class of installations. Motor trucks were used for industrial purposes and it was essential that the company's salesmen should possess specialized technical knowledge in order to show prospective customers the specific manner in which the trucks would meet their requirements. In that respect the truck market and the locomotive market were similar. The market for trucks, however, extended over a wide area with a relatively large number of potential customers whose identity was not known to the manufacturer. For the trucks, moreover, it was necessary to provide auxiliary repair service.

The third type of market was that for passenger cars. Passenger cars belonged in the category of consumers' goods. It was necessary that these goods be distributed to a large number of dealers who would resell single cars to individual consumers unknown to the manufacturer. For this market, auxiliary service also was required, but the methods of stimulating demand were quite different from those suitable for trucks. Because of the differences in the nature of the company's markets, segregated sales forces were essential. The same salesmen could not sell satisfactorily locomotives and automobiles, and it usually was advantageous to segregate the motor truck sales organization from the passenger car sales organization.[2]

October, 1925 M. T. C.

[2] See also, for further consideration of the use of segregated sales forces for motor trucks and passenger automobiles, Rice Motor Company, page 153, and Clipper Truck Company, page 160.

Canastota Steel and Tube Company [1]

MANUFACTURER—STEEL PRODUCTS

Distribution Channels—*Change Proposed to Obtain Better Prices for By-Products.* The company, which manufactured steel, had disposed of the by-products from its coke ovens on a three-year contract with a chemical company which purchased about one-half the output on its own account and sold the remainder on commission. In order to insure the securing of the highest prices obtainable, it was proposed that the steel company should sell its by-products itself, although under a plan of direct sale it would be necessary for the company to employ salesmen solely for the sale of by-products.

(1922)

In the spring of 1922 a three-year contract between the Canastota Steel and Tube Company and the Pennsylvania Chemical Company[1] was about to expire. Under the terms of the contract, the Pennsylvania Chemical Company agreed to purchase or sell all the by-products produced in the coke ovens of the steel company. About half these by-products were bought outright by the Pennsylvania Chemical Company for use in making chemicals; the remainder were sold by the chemical company on commission to other users. The total sales of by-products of the Canastota Steel and Tube Company averaged about $700,000 a year. The chief items among the by-products were: pure benzol; toluol; solvent naphtha; commercial Xylol; phenol; naphthalene flakes; naphthalene balls; and sulphate of ammonia.

The by-products customarily were sold f.o.b. producer's plant. Prices were quoted per gallon on pure benzol, toluol, solvent naphtha, and commercial Xylol, per pound on phenol and naphthalene flakes and balls, and per 100 pounds on sulphate of ammonia. Under the existing sales arrangement, one man in the Canastota Steel and Tube Company's office supervised all sales and shipments of by-products. The general sales manager was not certain, however, that the best prices obtainable were received by selling in this manner. Several of the company's competitors did not enter into such contracts but placed the sales of by-

[1] Fictitious name.

products under the control of their district sales offices, in order to reach a wide market directly.

If the Canastota Steel and Tube Company adopted a plan similar to that employed by these competitors, at least one additional salesman would be required for each of the company's 14 districts, since the men then representing the company in the branch offices were not familiar with the by-products or acquainted with the potential customers. The expense of opening up such a new field would be large. There also was the possibility that the Pennsylvania Chemical Company would be antagonized if the contract was not renewed and would refuse to purchase any more materials from the Canastota Steel and Tube Company.

Commentary: The general sales manager apparently had only a meagre knowledge of the potential market for the by-products and of market prices for those materials. The first task should have been to ascertain how the prices that the company was receiving compared with prices offered by various purchasers of such materials. That was a question of fact. Facts also should have been obtained regarding the potential market and means of developing sales.

So far as the form of sales organization was concerned, if the company were to have taken over the sales of by-products, it undoubtedly would have found it necessary to maintain permanently separate salesmen for the by-products. The principle of a segregated sales organization would have applied here as in the Tinkham, Littell Company, Incorporated, case.[2]

November, 1925 M. T. C.

[2] Tinkham, Littell Company, Incorporated, 1 H.B.R. 352; commentary, 2 H.B.R. 507.

Rice Motor Company[1]

RETAILER—AUTOMOBILES

Sales Organization—*Segregated by Lines of Products.* The manufacturer of the passenger automobiles for which the company held a local sales agency was about to place motor trucks on the market also. This raised the question as to whether the company should have all its salesmen sell both trucks and passenger cars or should use a separate sales organization for each.

(1921)

In February, 1921, the Rice Motor Company, Philadelphia distributor for the Peterson "6,"[1] selling at $1,650, f.o.b. Detroit, received notice from the manufacturer that a Peterson truck soon would be started in process of manufacture. The new truck was to be of 1½-ton capacity, with a 4-cylinder motor. Advance notice was given by the manufacturer to all distributors in order that they might make plans for distribution of the truck and also that they might benefit by the advertising campaign which was to be started as soon as the trucks were ready for delivery. This notification raised the question as to whether a separate sales organization should be developed by the Rice Motor Company for the sale of Peterson trucks or whether the same salesmen should sell both trucks and passenger cars.

The partners in the Rice Motor Company knew that one of their chief competitors, the Philadelphia Rowley Company,[1] in marketing Rowley trucks and passenger cars used the same sales organization for both products. The Rowley truck was a 4-cylinder machine of 1¼-ton capacity. Several of the Philadelphia Rowley Company's salesmen had built up a larger truck clientele than passenger car clientele, while others had a larger passenger car clientele. The Philadelphia Rowley Company exhibited trucks and passenger automobiles in the same showrooms and used the same repair shop for both. Reports on new trucks registered in the states in the Rice Motor Company's territory showed that the Rowley truck was one of the leaders in sales. For the partners in the Rice Motor Company it was a question

[1] Fictitious name.

whether this leadership had been obtained through special sales efficiency or because the Rowley truck had been among the first of its type on the market.

The registration records indicated that the Sargent[2] truck also was one of the leaders in this territory. This truck was likewise a 4-cylinder machine with a capacity of 1½ tons. In contrast with the policy of the Philadelphia Rowley Company the Waterhouse Company,[2] which was the distributor for Sargent trucks, separated its truck organization from its passenger automobile organization. Different salesmen were employed, and separate repair and reconditioning departments were maintained for trucks and passenger cars. Each truck salesman was given a definite sales district for which he was held responsible. The company secured at regular intervals lists of all trucks of any make sold in each district, and in that way was able to find out when and where the salesmen missed opportunities and which competitors were obtaining orders.

Factory specifications for the Peterson truck indicated that it would be as sturdy and adaptable to all uses as either the Sargent or Rowley trucks. Variety of bodies and uses for the trucks were to be stressed instead of styles of bodies, as in the case of passenger cars. Attention was to be called to economy and ruggedness, rather than to speed and easy riding qualities. Because of the common practice of overloading light trucks, all vital parts of the machine were to be built 50% above engineering specifications. Nevertheless, it was expected that repairs and renewals would be required more frequently for trucks than for passenger cars. Extra room for workshops and extra repair men, therefore, would have to be secured.

Commentary: The experience of the two competitors of the company, so far as can be judged from the scanty evidence presented, was contradictory. It is probable, however, that the plan used by the Waterhouse Company, whereby the sales organization for trucks was separated from the sales organization for passenger cars, would be the more satisfactory for the Rice Motor Company. In such a case as this a combined sales organization, to be sure, permits greater freedom in giving assignments to salesmen according to the exigencies of the moment. That advantage, nevertheless, is likely to be more than offset

[2] Fictitious name.

by the gains from specialization. The market for trucks is more clearly defined than the market for passenger cars, and an individual customer often will buy several trucks. For trucks the requirements of each customer usually are well defined. His buying motives, such as efficiency in operation, durability, and economy in use, are rational. In effecting sales to him emphasis is placed on mechanical features and utilitarian performance. For passenger cars, on the other hand, it is more difficult to locate prospective customers, and their purchases are not governed so much by utilitarian requirements as by individual preferences, social considerations, and financial resources. In the purchase of passenger cars, emotional buying motives, such as emulation, pride in appearance, personal comfort, and means of securing recreation, have a large influence. With such distinct types of customers and such differences in buying motives between the two types, segregated sales organizations usually may be expected to yield better results than can be obtained from a consolidated organization.[3]

November, 1925 M. T.C.

[3] For other cases on the use of separate sales forces, see Tinkham, Littell, Incorporated, 1 H.B.R. 352; commentary, 2 H.B.R. 507; Lewis Motor Car Company, 3 H.B.R. 156; and Clipper Truck Company, 3 H.B.R. 160.

Lewis Motor Car Company[1]

RETAILER—AUTOMOBILES

Sales Organization—*Centralization of Responsibility Instead of Segregated Sales Force for Used-Car Transactions.* The company, an automobile retail firm, was faced with keen competition which resulted in losses from heavy allowances on used cars accepted as part payment for new cars. Another retailer with whose experience the company was familiar not only charged all items of cost to the used cars that properly belonged there but segregated the used-car department from the new-car department. The company, however, decided that its sales volume was too small to justify a policy of sales-force segregation and proposed instead to place one man in charge of setting allowances on used cars and to hold him responsible for excessive losses in that department.

Pricing—*Variance of Prices by Bartering Allowances on Used Cars.* The competition met by this retail automobile company was keen and resulted in heavy allowances on used cars accepted as part payment for new cars. The amounts of the allowances to be granted were left to the discretion of the salesmen, who tended to vary them according to the sales resistance encountered from the owners who wished to trade the used cars in on new cars.

(1922)

In 1922 the new manager of the Lewis Motor Car Company, which held a local agency for a well-known make of automobile selling at $3,500 f.o.b. Detroit, decided to revise the firm's system of allowances on used cars. During the depression of 1920-1921, the previous management, which theretofore had been successful for a long period, had suffered severe losses as a result of granting too liberal allowances on used cars.

Although in other years, when competition was less keen, the used-car business constituted a smaller percentage of the total, the firm's volume of business in dollars in 1921 was almost as great in used cars as in new cars. Used cars were taken in trade on about 80% of the sales of new cars, and frequently used cars were traded for used cars, with the result that the sale of one new car sometimes involved the handling and resale of several used cars. The experience of the Lewis Motor Car Company in dealing in used cars was thought to be not essentially different from that of other automobile retailers.

[1] Fictitious name.

Under the previous management, each Lewis salesman had sold both new and old automobiles and had received the same rate of commission on both types of sales. Difficulty had been experienced in disposing of the used cars, however, as a result of the preference of most salesmen for selling new cars. An attempt had been made to meet this difficulty by stipulating that each salesman must make a certain proportion of his sales in used cars. The amount of allowance given for a used car traded in was left to the judgment of the salesman, who was expected ordinarily to follow the current "market" on used cars. Allowances were estimated on the basis of approximately 40% off the original price for a model one year old and 20% more for each year thereafter. The depreciation on different models and on different automobiles of the same model varied so widely, however, that the market price on used cars never was well defined. It was the practice of some dealers, moreover, before reselling used cars to recondition thoroughly cars of the makes for which they held agencies but to do only superficial repairing on cars of other makes.

Salesmen always were inclined to give large allowances and frequently, rather than lose a sale, made an allowance which resulted in a loss large enough to offset a substantial portion of the profit on the sale of the new automobile. Under the conditions of keen competition prevailing in 1921, many dealers had thought it necessary, in order to secure sales, to allow salesmen to make excessive allowances regularly; the losses on the trade-ins were charged to the selling expense of new cars. This price-cutting had resulted in failure of the weaker dealers and had been one of the factors in bringing about a change of management in the Lewis Motor Car Company.

The only information compiled on the actual cost of the used-car transactions of the Lewis Motor Car Company was a monthly report made by the accounting department to the sales manager which indicated the allowance made for each used car, together with the expense for reconditioning, the cost of the material at invoice price, and direct labor at pay-roll rate. When the car had been sold, the net loss or gain on the basis of these costs was given. No charge, however, was made for selling expense, for indirect labor, or for general administration.

One of the largest and most successful automobile dealers in the same city as the Lewis Motor Car Company divided its sales organization into new- and used-car departments with separate showrooms, separate sales forces, and separate accounts. New-car salesmen had to receive authority for the allowance granted on any trade-in from either the head of the used-car department or his assistant. The amount of work to be done on a used car after it was accepted in trade and the price to be set for resale were determined by the used-car manager. All expenses for indirect as well as direct material and labor, for space, sales force, and general administration, which could be charged to the used-car department were so charged and were apportioned to the used cars sold. Fifteen per cent of the allowance on each car traded in was charged to the selling expense account of the new-car department. The used-car manager was expected to obtain a gross margin on the transactions in his department sufficient to cover the balance of the department's operating expenses.

The Lewis Motor Car Company employed only eight salesmen, however, and the new manager did not believe that the sales of his company were large enough to justify a separate organization for used cars. He was determined, however, to keep close control over used-car transactions. A means of control proposed was to place one man in charge of setting allowances on used cars and to hold him responsible for any excessive losses incurred from that part of the business. Although the manager did not expect that it would be possible to avoid losses on the used-car transactions, he thought definite limits could be established by this method beyond which the losses should not go.

Commentary: The amount of the trade-in allowances granted the purchasers of new cars was governed by the bargaining ability of those customers. This practice of leaving the amount of the allowances to be granted to the discretion of the salesmen constituted a varying price policy which was unfair to customers who were not skilled in bargaining or not disposed to barter; it also was subject to the general objections to a varying price policy.

The proposal to have one man set the allowances on used cars and to hold him responsible for excessive losses incurred in that department was not sound from the organization standpoint. This man would not be in a position to control expenses in the department. He would be

subject continually, furthermore, to pressure from the salesmen to grant larger allowances in order to facilitate the sales of new cars.

The reluctance of the manager of the company to use separate sales organizations when only eight men were employed was natural. It was not to be expected, however, that the salesmen would give equal attention to the sale of both new cars and used cars. The buying motives to be aroused were different for the two classes of cars and it would be an exceptional salesman who could shift from one approach to the other with facility. By segregating the used-car department from the new-car department, a risk would be incurred that the used-car salesmen would feel that they were dealing with an inferior article and that they might be handicapped thereby. This obstacle, however, could be overcome by the proper selection and training of the salesmen. In general, in such a case as this, a segregated organization is essential in order that the allowances on used cars can be governed by the resale prices and that the expenses of reconditioning and selling used cars can be properly controlled. In that case, the used-car department would determine the allowances to be granted in accordance with the probable resale prices and the amount of reconditioning that would be required. The establishment of separate departments in such a case as this ordinarily affords better control over each and furnishes a check on abuses.

November, 1925 M. T. C.

Clipper Truck Company[1]

MANUFACTURER—AUTOMOBILE TRUCKS

Distribution Channels—*Selection of Retail Distributors.* In a large district the company, which manufactured high-grade trucks, sold directly to selected retailers. Some of those retailers sold the company's trucks exclusively; some sold passenger automobiles as well; and others sold not only passenger cars but also low-price trucks. Because the average sales of the company's trucks per dealer were far larger for dealers selling those trucks exclusively than for the other dealers, the wholesale sales manager for the territory decided in so far as possible to utilize only those dealers who would sell the company's trucks exclusively.

Distribution Channels—*Sales Analyses to Aid Manufacturer in Organizing Sales Territory—(Commentary).* As a result of an analysis which it made of the sales of its retail dealers in one sales district, the company, which manufactured high-grade automobile trucks, decided to utilize, in so far as possible, only those dealers who sold the company's trucks exclusively. The commentator points out that the company's analysis, which showed total sales by types of dealers classified according to whether they sold the company's trucks only or other trucks and passenger cars as well, should have been supplemented by other analyses. The analyses recommended by the commentator would have shown to what extent the differences in the sales of the various types of dealers were the result of the number of makes of trucks and passenger cars handled, and how far the company advantageously could have gone in dividing the territories of its small dealers among the large dealers selling its trucks only.

(1925)

The Clipper Truck Company manufactured high-grade automobile trucks ranging in size from one ton to seven tons. It did not manufacture passenger automobiles. The company's sales organization stressed the reliability of the trucks, the nation-wide service which was provided for them, and the company's long success in the truck industry.

In the Southbridge district, which comprised six middle-western states surrounding a large metropolitan area, the Clipper Truck Company maintained one branch and two subbranches. Retail salesmen sold within a redius of ten miles of the city of Southbridge. Wholesale salesmen covered the rest of the district. Six

[1] Fictitious name.

wholesale salesmen were located at the district headquarters and two were located at each of the subbranches. It was the duty of wholesale salesmen to select retail dealers in the district to sell Clipper trucks and to give service to purchasers. Where no dealers were available, wholesale salesmen sold directly to users.

Although dealers were granted exclusive territories, the branch wholesale salesmen sometimes sold to customers in dealers' territories. Whenever a dealer decided that he had done all that he could toward selling a truck to a customer and was about to lose a sale to a competing truck salesman, he was expected to call upon a branch wholesale salesman to aid in closing the sale. The wholesale salesman was given credit for such a sale and received a commission on it. Although there was no fixed policy, the dealer frequently was given a 5% bonus when the branch wholesale sales manager believed he had done his best to make the sale.

During the year ending September, 1924, 36 dealers had contracts with the Southbridge district branch. The wholesale sales manager for that district grouped those dealers into four classes: dealers in Class A sold no trucks except Clipper trucks, and no passenger cars; dealers in Class B sold, in addition to Clipper trucks, passenger automobiles retailing for $3,500 or more apiece; Class C dealers sold passenger cars in the $1,200 to $1,500 price range; Class D dealers sold passenger cars retailing for less than $1,000, and, in some instances, low-price trucks. Some of the Class D dealers were little more than order takers performing a general repair service and carrying a small stock of parts. Many of the dealers in Classes C and D were located in relatively sparsely settled communities.

Exhibit 1 shows sales of Clipper trucks in the Southbridge district for the various classes of dealers for the year ending September, 1924. In that year, 5 of the 36 dealers in the Southbridge district sold Clipper trucks exclusively. Those 5 Class A dealers together sold more Clipper trucks in that year than did the 31 other dealers together. Eleven of those 31 dealers sold no Clipper trucks at all during the year. Because of the comparatively few Clipper trucks which were sold by the dealers who also sold passenger cars and other trucks, the Southbridge wholesale manager contemplated utilizing, in so far as possible, only dealers who would sell Clipper trucks exclusively.

EXHIBIT 1

NUMBER OF DEALERS SELLING CLIPPER TRUCKS IN SOUTHBRIDGE DISTRICT AND SALES BY CLASSES OF DEALERS, YEAR ENDING SEPTEMBER, 1924

Class of Dealers	Number of Dealers in Class	Number of Trucks Sold
A	5	101
B	9	60
C	10	22
D	12	8

The company usually allowed dealers a discount of 20% off list prices on trucks and parts. In some instances the margin allowed on trucks was reduced to 10%. The dealers frequently requested a larger margin in order to be able to grant concessions on used trucks when necessary, but the company instructed the dealers to sell the trucks on a quality basis rather than on a price basis. All the dealers were in competition with salesmen from factory subbranches of the principal competing truck manufacturers.

The dealers were required to dispose of used trucks accepted in trade. Within limits, the dealers were allowed to sell to customers on deferred payments. The district credit manager watched deferred-payment sales closely. A deposit of 25% was required with the order, and the district office accepted the customer's note with the dealer's endorsement for the balance. There was little variation among the different classes of dealers in the number of instalment sales.

In the year ending September, 1924, six of the Clipper truck dealers in the Southbridge district went out of business or canceled their contracts with the company. Of those six dealers, three were in Class D, one was in Class C, and two were in Class B.

In general, small dealers were likely to make strong showings for a period varying from six months to a year and then to make few, if any, more sales for a long interval. It sometimes happened that shortly after accepting an agency for Clipper trucks, a small dealer secured a few sales on deferred payments, accept-

ing used cars in trade. If a customer did not have available funds to make the 25% deposit required, the dealer very likely paid the difference and accepted an additional note from the customer. Frequently the dealer was unable to dispose immediately of the used car taken in trade. Within a short time his capital was tied up and he had reached the limit of his bank resources, whereupon he was forced to suspend the sale of more trucks.

The Clipper Truck Company considered a widespread installation of branches and subbranches inadvisable. Two of its principal competitors had established numerous branches, but apparently at disproportionate cost. One competing truck company had shut down some of its subbranches during 1925. Furthermore, that competitor's balance sheet steadily had been growing more unfavorable during a period that had been one of good business for the Clipper Truck Company. The other competitor had nine branches and more than that number of subbranches in the Southbridge district. Supposedly reliable figures showed that one of those branches sold no trucks during the six months ending March, 1925, and that some other branches sold so few trucks that, in the opinion of the Clipper Truck Company, their operations in those six months could not have been profitable.

The wholesale sales manager of the Southbridge district was of the opinion that the company should leave no part of its territory without a retail dealer. He decided, however, to shift from dealers in Classes C and D to dealers in Classes A and B wherever possible and, in so far as he could, to use only those dealers who would sell Clipper trucks exclusively.

Commentary: The outstanding fact in this case is that, for the dealers who sold Clipper trucks only, the average sales per dealer were 20 for the year, whereas those dealers who sold both trucks and passenger cars averaged sales of less than 3 trucks per year per dealer, and the dealers in Class B averaged less than 7 Clipper truck sales per year. Wide differences between the territories of the various dealers certainly existed, and it is probable that many of the dealers who were selling both trucks and passenger cars could not have earned a livelihood on the sale of trucks alone. The evidence in this case, nevertheless, tends to support the conclusion, stated in the commentary on the case of the Rice Motor Company, that for passenger cars and trucks "segregated

sales organizations usually may be expected to yield better results than can be obtained from a consolidated organization."[2]

The company's analysis of sales by classes of dealers was a sound initial step looking toward the proper organization of the sales territory. The next step would have been to compare the results shown by dealers in Class A with the results shown by those of the dealers in the other three classes who were operating in territories directly comparable with the territories of Class A dealers. Such an analysis would have tended to show to what extent the differences in the sales of the various classes of dealers resulted from the fact that some sold the company's trucks only and that others sold passenger cars and low-price trucks as well.

A further analysis then should have been made of the sales of dealers in Classes B, C, and D to determine which, if any, of those dealers maintained separate sales forces for trucks and passenger cars and just how much effect the segregation of sales organization had on sales. This analysis might have revealed that, for Classes A, B, and C, the best results were obtained by those dealers who, by selling a variety of trucks and passenger cars, were able to maintain separate sales organizations for each type of product.

Finally, if these supplementary analyses confirmed the evidence of the original analysis showing that small dealers selling both trucks and passenger cars were less suitable dealers from the company's standpoint than were larger dealers, an additional analysis should have been made to ascertain whether the territories in which small dealers were situated could not have been divided advantageously between larger dealers, without unduly handicapping customers in securing satisfactory service for the upkeep of their trucks.

The facts brought to light by such analyses as these would have helped to determine the answer to the basic question of how far the company should have gone in arranging its sales territories so that each would support a dealer who was engaged solely in the sale of the company's trucks.

March, 1926 M. T. C.

[2] See page 155.

Excelsior Company[1]

MANUFACTURER—WRITING PAPER

Sales Organization—*Change from Functional Form to Territorial Form.* The company, which manufactured writing papers, found that with its administrative organization on a functional departmental basis its small customers had to correspond with the several departments handling: sales; credit; claims and grievances; and shipping. Those small customers, as a result, did not receive adequate attention. To improve this situation, the company decided to reorganize the sales office. Under the new plan sales territories were created, and a sales manager was appointed in the sales office for each territory. He alone would communicate directly with the customers in his territory, and thus would become familiar with the needs of each customer.

(1919)

Because its small customers apparently were not receiving adequate personal attention, the Excelsior Company, which manufactured writing papers, proposed to change the administrative organization as a means of improving the situation.

In 1919 the Excelsior Company was marketing its products in practically all parts of the United States. It sold directly to retailers and also to wholesalers; the sales to wholesalers were incidental, for the company intended to develop its market primarily among retailers. About 40% of the sales were made to customers who bought in large quantities. Most of those customers were regular patrons of the company, but among the large number of firms which bought in small quantities there was frequent change. Many small firms which previously had been customers no longer were purchasing from the company.

The company had sought to emphasize a policy of fair treatment to all its customers. Nevertheless, in the sales department and also in the credit and shipping departments more personal attention had been given to large customers than to small customers.

When the rapid turnover among customers buying in small quantities came to the attention of the executives, the sales, credit, claims and grievances, and shipping departments all were organ-

[1] Fictitious name.

ized functionally. The claims and grievances for all customers, for example, were handled directly and exclusively by a single department, and all collections were made directly by the credit department. The company had planned to carry this specialization of functions further as the organization expanded.

In order to improve the service given small customers, however, the company decided that the sales office should be reorganized with territorial rather than functional specialization. According to this plan, the hiring and control of all salesmen for all territories was to be centralized under one head. Advertising also was to be centralized, and there was to be a single credit department. The country was to be divided into territories, and each territory was to be assigned to one man in the sales department. For his territory he was to have charge of the routine supervision of salesmen, of claims and grievances, and of all correspondence with customers. In dealing with matters such as credit, he, of course, was to be guided by the decisions of the credit department, but no department other than the territorial sales department was to be permitted to communicate directly with individual customers except in the case of delinquent accounts to which severe collection methods were to be applied.

Commentary: The plan which was adopted provided for functional control where that was essential but harmonized the functional organization with an operating territorial organization. The territorial plan afforded an opportunity for the man in charge of each geographical division to become so familiar with local conditions within the division and so well acquainted with the business requirements and practices of individual customers that the small customers would receive adequate attention. The company's decision was sound in that it provided for undivided administrative responsibility for maintaining and strengthening relations with customers within each geographical division.

March, 1926 M. T. C.

Circle Auto Supply Company[1]

WHOLESALER AND MANUFACTURER—AUTOMOBILE ACCESSORIES

Sales Organization—*Segregation of Sales Force by Types of Products.* About one-half the company's sales in the seven wholesale branches which it operated were made up of accessories which it purchased for resale. The other half were made up of tires and batteries manufactured by the company. An increase in volume of sales and a strengthening of the company's competitive position were desired. It was proposed that the traveling salesmen employed by the company at each wholesale branch should be segregated into two groups—the men in one group to sell accessories only, and the men in the other group to sell tires and batteries only. Such specialization, it was suggested, might result in better salesmanship and larger sales, but apprehension was expressed that the segregation might cause an increase in operating expenses.

(1924)

The Circle Auto Supply Company was one of the principal wholesale distributors, in the Middle West, of automobile tires, batteries, accessories, and equipment. In addition to those items, the company, in 1923, had begun to sell a complete assortment of radio products. Since 1920 the company had manufactured automobile storage batteries, and, since 1921, it had manufactured automobile tires. Each of those products it made in two grades; the higher quality was branded with the Circle trade-mark, but products of the lower grade bore other brands. There was a price differential between the two grades of from 7% to 10%. The company purchased no tires or batteries for resale. The company's headquarters were in Indianapolis, and it maintained six wholesale sales branches in the surrounding territory. The company had a reputation for selling high-grade articles and for quoting fair prices to retailers.

Within the branch territories the same salesmen sold all the company items, both those which the company manufactured and those which it purchased for resale. Under this method of selling, the sales manager for the branch territories found difficulty in directing the selling efforts of salesmen on all products sold. Some of the salesmen stressed a few items of equipment and

[1] Fictitious name.

neglected batteries and tires; others were interested primarily in selling tires. Not all the salesmen were familiar with the selling points of all the products which they were expected to sell; many of the salesmen were little more than order takers. In view of this situation it was proposed that the company establish two separate sales organizations, one for tires and batteries, and one for equipment and accessories. Radio products would be classed with equipment and accessories.

The firm's factory organization maintained a separate sales force of nine men for selling batteries and tires in that part of the United States which was not included in the wholesale branch territories. Each of the nine salesmen sold both tires and batteries. The operations of those salesmen were entirely distinct from the operations of the wholesale department, and no issue regarding those salesmen is raised in this case.

In 1923 the total sales volume of the company's wholesale branches was approximately $2,000,000, of which automobile accessories constituted 45%, radio products 5%, and tires and batteries each 25%. The company's gross margin on tires was 12% or 13%. The gross margin on batteries was about 15%. The company desired a gross margin of 25% on accessories. The average gross margin for the company as a whole had been 21.7% in 1923. The average amount of an order for accessories had been estimated at $1.50; no orders were accepted for less than 50 cents. The average order for tires was about $50, and for batteries, about $30.

The company sold a complete variety of automobile accessories, including from 8,000 to 10,000 items, as well as equipment for garages and automobile repair shops. The company did not sell replacement parts for automobiles. Only one or two of the accessories were sold under the company's private brand. It was the policy of the company to specialize in the sale of accessories for which the manufacturers granted exclusive agencies. In 1923 approximately 35% of the company's sales of accessories were of products for which the company held exclusive agencies; the company expected that that proportion would exceed 50% by the end of 1924.

The territory of the company's sales branches was within a radius of approximately 250 miles from Indianapolis. Exhibit 1

Exhibit 1

Percentage Distribution of Sales of Branches of Circle Auto Supply Company in 1923 by Branches, and Number of Salesmen in 1924 by Branches

Location of Branch	Percentage of Total Sales for 1923	Number of Salesmen in 1924
Louisville	16%	5
Columbus	12	4
Cincinnati	18	5
Fort Wayne	10	4
Nashville	12	4
Peoria	10	3
Indianapolis	22	7
	100%	32

shows the location of the branch sales offices, including the main office at Indianapolis, the percentage distribution of total sales among those branches in 1923, and the number of salesmen at each branch in 1924.

The company's customers included retail shops selling automobile accessories, tire shops, garages, repair shops, filling stations, and hardware stores; the total number of accounts was about 8,000. Complete stocks were maintained by each of the branches, and each branch billed the customers which it served. The terms of sales, which varied in the different sections, were 60 days for some customers, 30 days for others, and the 10th of the month following the date of invoice for the majority. The company granted no cash discounts.

In the city districts the salesmen called on customers once each week; salesmen in districts outside the cities called on their customers once in every three or four weeks. During 1923 the sales force numbered 36 men. In the spring of 1924, however, after the sales manager had studied the various territories, he decided to concentrate on the more profitable territories and to reduce the number of salesmen to 32. Sales of two of the branches increased after that reduction in the sales force. The average sales per salesman in 1923 were about $55,000. It was the aim of the company to increase the average annual sales per salesman to about $65,000. A quota was established for each salesman, chiefly on the basis of previous sales records.

All the company's salesmen were paid salaries and were allowed traveling expenses. The salaries ranged from $1,800 to $3,600 per year. The company provided automobiles for the salesmen who traveled outside the cities. In addition to his salary, each salesman was given an opportunity to earn a yearly bonus based on the ratio of his salary and expenses to his sales. If a city salesman's salary and expenses for a year were less than 3% of his sales in that year, he was given the difference between the actual percentage and 3%, the maximum percentage permitted city salesmen under the bonus plan, as a bonus; the stipulated maximum for most country salesmen was 5% instead of 3%, but for two or three salesmen working in outlying districts the maximum allowed was 5¾%. Only a few of the salesmen received bonuses for 1923, and total salesmen's salaries and traveling expenses for that year amounted to 6% of salesmen's total sales.

The company granted exclusive agencies to retailers for the sale of tires. In a town with a population less than 15,000 it was the company's policy to grant but one exclusive agency for Circle tires. In a city with a population of 15,000 or more, the company granted several agencies, with the consent of the original agent. The company's tire agents usually sold accessories and several brands of tires in addition to Circle tires. The company received orders from other tire retailers as well, usually for smaller quantities than were ordered by the exclusive agents; the prices to those other retailers were 7½% higher than the prices offered to the exclusive agents. Because of the competition of other manufacturers for orders from some of the successful Circle agents, the company billed from 40 to 50 retail agents directly from the factory at prices only 5% higher than the factory prices to the company's wholesale branches. The branches, however, continued to sell accessories to those agents.

The company had granted exclusive agencies for the sale of batteries. The agents for Circle batteries maintained service stations. At each of the service stations, a mechanic was employed who had been trained in the construction and repair of Circle batteries.

Two missionary salesmen for tires and two for batteries operated in the branch territories from the main office. Those salesmen called on the company's exclusive agents. All orders taken

by the missionary salesmen were credited to the branch salesmen.

The sales manager in the main office supervised the branch managers, to whom the salesmen were responsible. Although the sales manager formerly had participated in the purchase of accessories and equipment, a general purchasing agent in the main office now was responsible for all buying. When a branch manager required replenishment of the stock of a product, he sent an order to an assistant buyer, who also acted as a stock clerk at the home office. The order stated the quantity desired and the quantity on hand. If the quantity desired could not be secured from the surplus stock in another branch, the main office placed an order with the manufacturer. Occasionally branch managers sent orders directly to manufacturers, and remitted payment, but in all such instances the approval of the main office was required. The company made no contracts with manufacturers for specified quantities to be purchased during the year, and the general policy was merely to purchase to replenish stocks. For some items, the company maintained 60-day stocks and for other items it maintained 30-day stocks. Branch managers sent stock reports to the main office each month and supplied the main office with records of physical inventories periodically.

The company had issued a catalog in 1923, at a cost of about $7,000, but it issued no catalog in 1924. In that year it sent to customers a monthly publication which listed from 100 to 150 items together with their prices. In each town or city in the territories of its branches, the company paid for one weekly quarter-page newspaper advertisement in which the name of a retailer selling its merchandise was displayed. In addition, the company rebated one-half the cost of newspaper advertisements inserted by customers.

The partners in the firm were undecided as to the desirability of segregating the salesmen in each district into two groups: (1) tire and battery salesmen, and (2) accessory and equipment salesmen. It appeared probable that by specialization the salesmen would become better acquainted with the selling points of the merchandise sold by the company and that the sales of each of the two groups of merchandise could be increased. It was questioned, however, whether a specialized sales force could secure an increase in sales sufficient to compensate for the in-

creased traveling expenses which would result from that arrangement. The sales manager was of the opinion that in most localities the company's tire and battery agents were not the most prominent local dealers in automobile accessories. The agents, furthermore, sold competing products and required constant solicitation for repeat orders. Price competition was strong in the industry. Another objection raised to the plan of segregated sales forces was that under such a plan a customer could not order, from one salesman, all the products sold by the company.

COMMENTARY: The proposed plan of segregating the sales forces in the wholesale branches presented several advantageous features. Under that plan the duplication of effort by the four missionary salesmen probably could have been avoided, since they presumably would have become regular salesmen under the new plan. By segregation, the time and frequency of calls could have been regulated more advantageously, for the same frequency of call from salesmen probably was not required by tire and battery agents as by other accessory dealers.

Despite these potential advantages, however, the plan should not have been adopted. Although the average sales volume per salesman employed by this company already was higher than the average for the industry,[2] it was much lower than in numerous other industries,[3] and the company should have made an effort to increase the average and to avoid taking steps which might lower it. With scattered customers, a few in each city or town, the average sales per salesman were almost certain to be less under a plan of segregated sales forces than under the existing plan. Customers who sold tires and batteries and also accessories, furthermore, would be irritated if any salesman employed by the company was not permitted to accept an order for any item in the company's line. As a matter of practice, this influence would have been so strong that within a relatively short period of time the specialized salesmen would have again become general salesmen. Inasmuch as numerous customers inevitably would be dealing in several lines sold by the company, this last point is the one to which the greatest weight attaches.

This case presents a contrast to the case of Tinkham, Littell, Incor-

[2] The company's average sales per salesman in its wholesale branches in 1923 had been $55,000. For 91 automotive equipment wholesalers the average sales per salesman in 1923 were $37,000.—Bureau of Business Research, Harvard University, Bulletin No. 42, *Operating Expenses in the Wholesale Automotive Equipment Business in 1923*, p. 16.

[3] For general observations on this point, see Copeland, Melvin T, *The Cost of Doing Business, Printed Report Number 3, 1925*, published by the Department of Merchandising, Automotive Equipment Association, Chicago.

porated.[4] The customers for the several products made by Tinkham, Littell, Incorporated, comprised, for the most part, distinct groups, and that circumstance warranted the operation of a segregated sales organization. In the Circle Auto Supply Company's wholesale business, however, many customers purchased all the lines sold by the company. With such overlapping of purchases a plan of segregated sales forces was not likely to succeed. The fact that in many localities the company's tire and battery agents were not the most prominent dealers in accessories, does not affect this conclusion; it suggests rather the perplexities of securing satisfactory retail distribution of these classes of merchandise.

This case has some points in common with and some in contrast to the case of the Intervale Supply Company.[5] In both instances attempts were being made to combine a wholesale business with a manufacturing business, and in both instances incongruities and conflicts of interest appeared. The Intervale Supply Company, however, was primarily a manufacturing organization, whereas the Circle Auto Supply Company was primarily a wholesale merchandising enterprise. Moreover, under existing conditions of severe competition from large manufacturers in the tire and battery industries, the Circle Auto Supply Company's future in merchandising accessories was at least as promising as its future in the tire and battery trade. Hence, the company should not have sacrificed its accessory business to the promotion of tire and battery sales.

The grounds on which a conclusion adverse to a policy of segregating the sales forces is reached here are akin to the reasons which led to a territorial organization in the case of the Excelsior Company.[6] In both instances the final conclusions aim to avoid division of responsibility for dealings with individual customers; in the Circle Auto Supply Company's problem, this division of responsibility pertained to the operations of the salesmen, in the Excelsior Company's case to the operations of the administrative organization at the home office. Neither division was desirable.

March, 1926 M. T. C.

[4] Tinkham, Littell, Incorporated, 1 H.B.R. 352; commentary, 2 H.B.R. 507.

[5] See page 26.

[6] See page 165.

HYDE SHOE COMPANY[1]

MANUFACTURER—SHOES

DISTRIBUTION CHANNELS—*Exclusive Agencies Used for Retailing Special Product.* The company manufactured and sold directly to retailers women's shoes of medium grade. In 1922 the company undertook to manufacture and market under an exclusive manufacturing agreement a new, special type of arch-correcting shoes for women, to be sold under the name of the surgeon who had developed the shoe. The question arose as to whether the company should attempt to sell the shoes to all its retail customers or should grant exclusive agencies to selected retail customers for the sale of the shoes.

SALES ORGANIZATION—*Segregation of Sales Force by Types of Products—(Commentary).* The company, which manufactured and sold directly to retailers women's shoes of medium grade, undertook to manufacture and market a new type of arch-correcting shoes for women. The commentator states that the company should have marketed the new type of shoes through exclusive retail agents and that the use of segregated sales forces for the regular line and the new line would have been inadvisable; in his opinion, there would have been little danger of conflict in the interests of retailers selling the regular line only and retailers selling the special line as well, and any gain realized from the use of a specialized sales force would have been more than offset by increased traveling expenses consequent to segregation.

(1922)

In 1922 the Hyde Shoe Company agreed to manufacture and market a new type of corrective shoes designed by Doctor John M. Bacon, a young orthopedic surgeon. Dr. Bacon recently had developed a method of treatment for misshapen feet and needed the special shoes for use in connection with his treatment of women's feet. The Hyde Shoe Company also agreed to advertise the surgeon's name and to pay him a commission on sales in return for the exclusive right of manufacture. One of the questions raised in planning the marketing of this new and special product was whether the company should distribute the shoes through exclusive retail agencies.

The Hyde Shoe Company, which was located in a small city in Ohio, manufactured women's shoes of a medium grade at the

[1] Fictitious name.

rate of 1,000 pairs a day. The officers of the company, all of whom were related, owned most of the company's stock. They were conservative and did not undertake new projects readily. The company had sufficient surplus to finance the manufacture and marketing of the new arch-correcting shoes. The balance sheet of the company as of July 1, 1922, was as follows:

BALANCE SHEET OF THE HYDE SHOE COMPANY AS OF JULY 1, 1922

Assets		Liabilities	
Real Estate	$ 4,400.00	Capital Stock	$ 75,000.00
Building	51,031.11	Depreciation Reserve	28,505.58
Cash	4,444.21	Accounts Payable Not Due	10,294.91
Merchandise	51,382.06	Surplus and Undivided Profits	191,666.42
Accounts Receivable	56,700.17		
Machinery	7,680.00		
U. S. Certificates of Indebtedness	129,829.36		
Total	$305,466.91	Total	$305,466.91

In 1922 the company was selling its shoes directly to retailers in Ohio, Indiana, Michigan, and Illinois. The bulk of the sales were made by salesmen who visited each customer once each season. The company kept in stock the shoes which it expected to be most popular for the season and supplied its customers with catalogs from which they could send in repeat orders and fill-in orders by mail. The low shoes were sold at retail prices of $7 to $8 a pair, and the high shoes were sold for $8 to $9 a pair. The company advertised its shoes by means of the catalogs of shoes in stock, a few dealer helps, and displays at national and state shoe conventions. The company never had advertised in general magazines, newspapers, or trade papers.

The shoes which the Hyde Shoe Company agreed to manufacture for Dr. Bacon were to be of the welt type, made of soft, flexible leather, with wide toes and low counters, to permit free motion of the ankle. The shoes were to be built to conform to the natural lines of the foot, and were to be slightly higher on the inside than on the outside, in order to direct the weight of the body to the center of the foot. This was a new feature in shoe building. The shoes were to be made without steel shanks, so that the soles could be molded to the natural lines of the foot

instead of to the shanks. Most arch-correcting shoes on the market were built with steel shanks.

In marketing the new product the company had the choice of selling to all its retail customers or of selecting certain retailers as exclusive agents. The chief considerations, in the opinion of the executives of the company, in favor of distribution through exclusive agencies were briefly as follows: The product was special in nature. The company intended to advertise the distinctive features of the shoes, and use of exclusive agents would facilitate advertising. Other manufacturers of corrective shoes were advertising them in national trade papers. Exclusive agents also could be expected to secure the cooperation of local foot specialists.

There was doubt, on the other hand, as to whether the volume of sales would be as large if exclusive agents were used as if the shoes were sold to all the retailers to whom the company sold other types of shoes. If the company were to sell the new type of shoes to exclusive agents only, there was uncertainty as to whether those shoes could be sold effectively by the company's regular sales force; it might be necessary to employ a special sales force for marketing the new product.

COMMENTARY: The market for the arch-correcting shoes which the company agreed to manufacture was highly specialized. To cater effectively to this sort of market it would have been necessary not only to acquaint consumers with the specific merits of the shoes, but also to inform them where the shoes could be purchased, and to make certain that the individual needs of each consumer purchasing the arch-correcting shoes received careful attention. Only by close cooperation between retailers and manufacturer could the general and local advertising plans have been correlated. Only a few stores, at most, in each community would have been disposed to train employees for the sale of orthopedic shoes, and the volume of sales for any one brand of such shoes in a single city was not likely to have been large enough to warrant more than one retailer's carrying a complete range of sizes and widths in stock. These circumstances indicate clearly that the company should have granted exclusive agencies to selected retailers for the sale of its arch-correcting shoes.

If the company granted exclusive agencies for the sale of the new type of shoes, there would have been some advantage in using a separate sales force for the new line, inasmuch as the company's regular line

of shoes was sold largely to retailers to whom exclusive agencies for the arch-correcting shoes would not have been granted. Such a segregated sales organization would have tended to avoid embarrassment in dealing with agents and non-agents and to foster specialized sales promotion. The danger of conflict of interest between retailers, however, was slight, for most retailers would not have been desirous of holding agencies for orthopedic shoes, nor would the sale of orthopedic shoes by the retailers to whom agencies were granted have infringed upon the market for the regular line of Hyde shoes. By having both lines sold by the same salesmen, moreover, economies in traveling expenses could have been realized which probably would have exceeded any gain to be realized by the employment of specialized salesmen in marketing the new line. In this case, therefore, a segregated sales organization was not advisable.

March, 1926 M. T. C.

Grace Shoe Company[1]

MANUFACTURER—SHOES

Returns and Allowances—*Charging Expense for, in House-to-House Selling.* The company employed salesmen to sell its shoes from house to house. It was suggested that, if the company charged the salesmen with the expense of handling shoes returned by customers, the proportion of shoes which were returned might be reduced. The company decided, however, that such expense should be borne by the company as one of its operating expenses.

(1924)

The Grace Shoe Company manufactured men's, women's, and children's shoes at its factory in New England. The retail prices of the company's product ranged from $2 to $6 a pair. The company employed 40 salesmen to sell from house to house. All customers were given a "satisfaction or money back" guaranty. Refusals and exchanges of shoes were so common under this plan that the company sought some means of encouraging salesmen to exercise greater care in taking orders and in fitting shoes.

At the time of ordering, customers were required to pay salesmen deposits of from 40 cents to $1.25 a pair, according to the price of the shoes. This amount was retained by the salesman as his sole compensation. The shoes were sent to the customers by mail for cash on delivery, the amount collected upon delivery being the balance due on the shoes.

In 1923 the company's sales were $150,000. Approximately 5% of the shoes sold in that year were returned for exchange or were refused by the customers. The average cost of postage alone in making exchanges was 16 cents a pair. Because the retail prices of the company's shoes were fixed at even quarters of a dollar, the company decided that it was not feasible to pass this charge along to customers by making a corresponding increase in the prices of the shoes. When shoes were refused by a customer, the customer's deposit was not returned unless requested specifically, in which instance the company paid the amount of the deposit to the customer and collected it from the salesman.

[1] Fictitious name.

In January, 1924, the production manager of the company proposed that the full cost of exchanging shoes be deducted from the salesmen's commissions. He pointed out that the commissions were paid to salesmen for completed sales and that, if the shoes had to be exchanged, the exchange costs should be borne by the salesmen. The sales manager protested against this proposal because it had been his experience that usually the customers rather than the salesmen were responsible for misfits. It frequently happened that children were not at home when the salesmen called and that parents ordered shoes by guess or from sizes stamped on old pairs of shoes purchased from a different source.

The sales manager stated that salesmen's commissions were relatively low and that any attempt to charge the salesmen with the cost of exchanging shoes might cause them to leave the employ of the company. This did not seem a serious contingency, but, nevertheless, the executives decided that the situation was one attendant upon house-to-house selling, and that the cost of exchanging shoes should be assumed by the company.

Commentary: The company had small grounds for complaint. Its sales-force expense, apparently about 20% of its sales, was less than a retailer's normal margin on such merchandise. Nor was the rate of compensation more than enough to permit a salesman to earn a fair income. The proportion of shoes sold which were returned for exchange, or acceptance of which was refused, was low for this type of business. Five per cent of the sales was not an exceptionally high ratio for return goods in a retail shoe store, and it would not have been surprising had the ratio been higher on house-to-house sales.

It is doubtful if the company could have reduced the ratio of return goods appreciably by penalizing the salesmen, and it also is improbable that capable salesmen would have accepted the imposition of the penalties unless their rate of compensation had been increased sufficiently to offset the charges. Under the circumstances, the company properly concluded that the expense of handling return goods was one of its own operating expenses.

April, 1926 M. T. C.

Pulitzer Company[1]

WHOLESALER—DRUGS

Sales Emphasis—*Customer Records to Provide Information for.* The company, a wholesale drug firm which sold merchandise that yielded widely varying gross margins, endeavored to direct sales emphasis to the more profitable lines. As a means of doing this more effectively, the company decided to keep a record for each customer of sales to him classified by merchandise groupings based on gross margins obtained.

Discounts—*Variance of Trade Discounts on Basis of Profitableness of Customers' Accounts.* The company, a wholesale drug firm which sold merchandise that yielded widely varying gross margins, allowed special discounts to retailers on the basis of the profitableness of their accounts to the company. Retailers sometimes complained that the discounts allowed them were too small. The company decided to keep records which would make available data as to the profitableness of each customer's account and to show these statistics to customers dissatisfied with the discounts allowed them.

Sales Emphasis—*Salesmen's Commissions as Means of Directing.* The company, a wholesale drug firm, endeavored to direct sales emphasis to the lines which yielded high gross margins. As a means of doing this, the company provided that the commissions paid salesmen should vary directly with the gross margins obtained on the merchandise sold.

(1924)

The Pulitzer Company, a drug wholesaler with annual sales of over $3,000,000, classified the merchandise which it sold into 19 groups, chiefly on the basis of the gross margins obtained. The sales manager of the company kept a record of total sales to individual customers by months, but no records were available of the distribution of each customer's purchases among the 19 groups of merchandise. The sales manager believed that a record of sales to individual customers by groups of merchandise would assist him to direct sales effort to the items which yielded high gross margins.

Although the primary basis for the classification of an article was the percentage of gross margin which the company obtained on the product, consideration also was given to the manufacturer from whom the product was purchased, the amount of advertising

[1] Fictitious name.

the manufacturer planned to do on that product, the discount given the company, and whether the product was sold to all wholesalers indiscriminately.

Group 1 included all patent medicines on which the company had to give extra discounts to retailers in order to meet competition and on which, as a consequence, the company judged that it earned no net profit. Thirty-two per cent of total sales were in that group. There were approximately 150 patent medicines on which the company's gross margin was satisfactory and on which the manufacturers gave the company good sales cooperation. Those items were placed in Group 2, and sales of them constituted 15% of total sales. Group 3 comprised chemicals, drugs, and pharmaceuticals, some of which were not sold under brand names and for which little sales effort was necessary to stimulate demand. Sales in that group were 15% of total sales. Eight per cent of sales were in Group 4, which consisted of merchandise prepared in the company's own laboratories. General sundries sold by the company were placed in Group 5 and formed 10% of the total sales volume. The company sold a line of chocolates branded with its name but manufactured by another company. These chocolates, sales of which comprised 1% of the total, were classed as Group 6. Each group from 7 to 12, inclusive, represented a specific line of merchandise, such as rubber goods, flash lights, or other specialty sundries. Each of these lines made up from ½% to 2% of total sales, and each was purchased from a different source. Sales of Group 13, soda fountain equipment and drug-store fixtures sold in connection with sales of other lines, were 2% of the total. Groups 14 to 18, inclusive, consisted of special brands of candies, nuts, or cigars, produced by various manufacturers. Sales of each of these groups were from ½% to 2% of total sales. Group 19 was soda-fountain equipment and drug-store fixtures sold by salesmen who specialized on that line; this group made up approximately 4% of total sales. The gross margin to the company on the various groups of merchandise ranged from 10% on a majority of the patent medicines to 40% on certain of the manufacturers' special lines and on fountains and fixtures.

A sales manager was in charge of the selling program of the company. Twenty-one salesmen were employed. Seventeen of

the salesmen were assigned specific territories, the size of which varied with the number of customers and their proximity to one another. Each of these salesmen sold all the company's lines to all customers in his territory. The other four salesmen sold throughout the company's entire territory, which included the area within a radius of about 100 miles from the city where the company was located. Two of these specialized on the sale of sundries, and two on the sale of soda fountains and other drug-store fixtures.

The company had approximately 1,500 active accounts, 100 of which were for customers in the city where the company was located. The company also had about 1,000 inactive accounts. The latter were the accounts of retailers who at some previous time had purchased furniture or fixtures from the company. City customers were called on once each week, and country customers, those outside the city in which the company was located, once in every two weeks.

Each salesman was given a quota in each group of merchandise which he sold, and, unless conditions changed, he was expected to fulfil his quota. The total volume of sales expected for each group of merchandise was distributed to the salesmen's quotas in proportion to individual percentages which had been established on a basis of the distance of a salesman's territory from the city where the company was located, the population of his territory, the number of retail druggists in the territory, and their dispersion.

The method of compensation for salesmen was based on the quota system. A uniform salary, which served as a drawing account, was given to all salesmen, and country traveling expenses were paid by the company. Commissions ranging from 1% to 5% were established for the 19 merchandise groups. The scale of the commissions was such as to encourage sales emphasis on groups most profitable to the company; the commission on each article was proportioned to the gross margin which the company secured on that article. Consequently, the salesmen received no commission for sales of items in Group 1. On any amount by which a salesman exceeded his quota for a group other than Group 1, the established commission was paid; and on any amount by which he failed to reach his quota, the commission

was deducted from the commissions which he earned on sales in other groups. If a salesman failed to reach his quota in a group which paid him 1% commission, he still could earn more than his drawing account by exceeding his quota in a group on which his commission was 5%, for instance. Thus, salesmen had an inducement to concentrate efforts on the groups which paid high commissions; those were the groups on which the company received large gross margins.

The company reserved the right to make new groupings of merchandise or to change items from one group to another at any time, but the reasons for such changes were explained to the salesmen. A salesman received credit for all sales in his territory, whether obtained in person or sent in by mail or telephone. That policy was adopted in order to encourage salesmen to build up permanent business for the company.

When a salesman wrote an order, he entered the group number opposite each item ordered. When the orders were received in the office, the grouping was checked. A daily sales total for each salesman in each group of merchandise was obtained on a computing machine. The machine was provided with keys corresponding to the group numbers, and, after the operator had set the amounts of the orders for a particular group in the machine, an accumulated total for the group was obtained by depressing the group key. The totals for each salesman were entered on his record sheet, which made available his daily sales by groups of merchandise for an entire month.

At the end of the month totals were taken for each salesman by groups of merchandise and entered on a summary file card. Each side of that card provided for a year's record by months and for a yearly total, so that when filled it presented a two-year comparison. The months were listed vertically on the left side of the card and the merchandise groups were listed across the top of the card. The salesman's yearly group totals were placed at the top of the group columns. In the columns, opposite the names of the months, entries were made of the group quotas and of the actual group sales for the various months.

At the end of each month a comparison sheet was compiled to show the relative accomplishments of the salesmen. The salesmen's names were listed in a vertical column, and opposite each

name entries were made of the salesman's sales by merchandise groups, his total sales, and his average sales for all groups. Salesmen's actual sales were divided by their quotas to obtain their percentages of accomplishment, and the percentages were entered in the proper columns. At the bottom of the sheet the average sale per salesman was entered for each group, and in each group column, underneath the group average, the name of the salesman having the highest percentage of accomplishment for the group was entered.

Salesmen conducted sales promotion work among their customers. The company did not advertise, but salesmen assisted retailers in arranging window displays from samples, cards, and posters furnished by manufacturers. Salesmen advised customers on up-to-date methods of merchandising, encouraging them to improve their net profits by emphasizing the sale of merchandise with satisfactory gross margins and also by increasing their rates of stock-turn.

The company had three buyers. One man was in charge of all sundry purchases, another purchased chemicals, drugs, and patent medicines, and the third purchased chiefly soda-fountain equipment and drug-store fixtures. Cooperation was effected between buyers and salesmen by the sales manager. Buyers kept the sales manager informed as to prices, new lines, manufacturers' special inducements, and merchandise which it was especially desirable to sell. The sales manager wrote a weekly letter to all salesmen, giving them the information he had obtained from the buyers and presenting the sales program for the week.

The Pulitzer Company had as its customers at least 95% of all the retail druggists in its territory. Most of these customers had patronized the company for at least 10 years. The company was not meeting strong competition except in some of the outer sections of its territory, and had only one active competitor. The sales of that competitor were about one-fifth those of the Pulitzer Company.

The average city order which the company received had a value of $28 and was made up of about 25 items. Corresponding figures for the country orders were $60, with 55 items. Some of the orders required merchandise from almost all the 19 groups of merchandise, but most of the orders were for not more than 12

groups. On an average day, 150 orders were received from the country and 60 from the city. Terms of payment were 1% cash discount for payment on the tenth of the following month. Special discounts were given to some customers on a basis of their volume of purchases from the company and the profitableness of their business to the company, conditional upon the payment of their bills within the discount period. Customers took the offered discounts on 50% of the company's sales. All customers were required to pay freight on merchandise except those in a few of the outlying districts where it was necessary for the company to pay the freight in order to meet competition. Orders of all sizes were delivered free of charge in the city in which the company was located.

In addition to the ledger cards to which the purchases of each customer were posted, the sales manager kept for his own use a record by months of total sales to individual customers. This record had been kept for approximately 10 years. Cards 6 inches by 4 inches were used, a separate card for each customer. On the cards, the months were listed vertically and the years horizontally. Each customer's total net purchases for a month were entered on his card at the end of the month. The total for the year was entered at the bottom of the card. The cards in use in 1924 provided for a seven-year comparison and were filed by towns. Since usually only one salesman sold in a town, the total purchases of customers in the town assigned to one salesman were expected to equal his total sales for the month as shown on his record sheet.

These records of total monthly sales to individual customers were useful in that they showed whether a customer's purchases as a whole were increasing or decreasing. The sales manager, however, desired a classification of sales to customers by merchandise groups whereby he could determine whether salesmen were selling specific customers as much of the profitable merchandise as was possible and whether such sales to any particular customer were on the increase or on the decline. Frequently customers came into the office of the Pulitzer Company and complained because they believed they were not receiving large enough discounts. They pointed to the increase in their volume of purchases from the company over a period of years and to the

fact that the discounts offered them by the company on many lines had remained approximately the same. The company in answer pointed out that the profitableness of sales, and not the volume of sales, should determine the discounts given. The company was handicapped, however, by not having statistics by means of which it could show the complaining customers the actual profit that it earned on sales to them.

If records of sales, classified by the 19 groups of merchandise, were kept for individual customers, the advisability of introducing any new product in specific sections of the territory could be gaged by a study of the sales record of a similar product. With such records, the company also could show a manufacturer just what percentage of the company's sales of certain items in any section were of his manufacture. The company thus would be able to cooperate more effectively with manufacturers in introducing new products or in checking up on the distribution of the manufacturers' lines.

The sales manager suggested that a daily record be made of all sales to individual customers by the 19 groups of merchandise, and that the daily records be summarized at the end of the month and entered upon a permanent file card similar to the summary card used for the salesmen's records. The additional records would not increase the work of the salesmen. Orders could be analyzed from day to day on the computing machines. The purchases made by a customer in each group of merchandise for the day could be entered on a sheet so arranged as to provide for a month's entries. At the end of the month, totals could be taken from the customer's daily sheet and entered on a summary file card for the use of the sales manager. The sales manager believed that the visible file system was the most practicable for these summary cards. The cards were to be 10 inches by 10 inches in size and were to be placed in the file in a lateral position with the name and address of the customer visible at the bottom. An example of the customer's summary file card which was proposed is shown as Exhibit 1.

Each side of a customer's summary file card provided for entries by months during a period of two years. Columns were provided in which to enter monthly figures for the total amount purchased, allowances, returned goods, and purchases in each of

RECORD OF SALES

	Total Amount	Allow-ance	Ret'd Goods	* 1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	
J																								
F																								
M																								
A																								
M																								
J																								
J																								
A																								
S																								
O																								
N																								
D																								
Total																								
J																								
F																								
M																								
A																								
M																								
J																								
J																								
A																								
S																								
O																								
N																								
D																								
Total																								

Name Address

* Numbers indicate product groups.

Exhibit 1: Card for recording, by groups of merchandise, monthly sales to a customer of the Pulitzer Company.

20 product groups; space was provided for 20 groups in anticipation of a further subdivision of merchandise. Totals were to be obtained by groups at the end of the year. It was estimated that the extra work involved in keeping these records would require the time of one girl. Another special computing machine, similar to the one in use, would have to be purchased at a cost of approximately $2,000. It was expected that the sales manager's secretary would have time to assist in entering the monthly totals on the summary file cards.

The Pulitzer Company decided to use the customers' analysis sheets and cards during 1925. The current sales to the special discount customers were considered first; at the end of January, 1925, the purchases of about 40 of the customers had been analyzed. It was planned gradually to analyze all 1925 sales. For the time being the work was done by the girl who also made the entries on the salesmen's analysis sheets.

At the end of each month the salesmen were given copies of the cards of the customers to whom they had sold, together with the sales letters from the sales manager, which commented upon

the records of the customers. Shortly after the records were introduced, several retailers were shown the cards in answer to their demands for larger discounts. The company believed that the analysis of customers' purchases was of value to the retailers, since the analysis helped the company to direct sales efforts to the lines on which it obtained the largest gross margins, which usually were the lines most profitable to the retailers. The sales manager was convinced that the record furnished him with the statistics which he needed in order to direct salesmen's activities effectively.

Commentary: The major question raised in this case is whether the company should have maintained a system of records of customers' purchases, classified by merchandise groups, as the basis for promoting the sales of items which yielded high gross margins and to facilitate the handling of requests from customers for extra discounts.

The company was engaged in a typical wholesale business and carried a large number of items. The rate of gross margin obtained on those items varied widely. The company, as a general policy, had undertaken to promote the sale of those goods in its stock which yielded high gross margins. The soundness of the policy of the company in placing emphasis on the high-margin goods is not an issue which is subsequently raised in this case.[2]

The company had adopted a plan for classifying merchandise into departments on the basis of the gross margin secured. It is to be noted that in Group 1, which was the largest of the groups by volume of sales, were placed those items on which the company judged that it secured no profit. Apparently the test of profitableness was whether the gross margin exceeded the average operating expense of the company. Although the decision to use this basis of classification of merchandise is not an issue in this case, it may be pointed out that no evidence is offered to show that the expense of selling the merchandise in Group 1 was as high as the average. In fact, extra efforts to promote the sale of high-margin merchandise might readily increase the average operating expense and thus superficially indicate that no profit was secured on the goods which sold most easily. Low margins obtained on merchandise in Group 1 were attributed to keen competition. Subsequently, however, it is stated that the company had only one serious competitor, whose sales were about one-fifth those of the Pulitzer

[2] The soundness of such a policy of sales emphasis on merchandise with high gross margins is the issue in the case of the Cleland Company, page 191.

See also the Menton Company, page 134.

Company. This suggests that the merchandise in this group was subject to a particularly elastic demand; the volume of sales very likely responded so quickly to a reduction in price that the company was led to reduce the gross margins from time to time as a means of increasing sales. Although these narrow margins at first might appear to indicate that the sale of such merchandise was unprofitable, the merchandise in this group, as a matter of fact, was carrying in the aggregate a large portion of the company's operating expenses, and the principle of joint cost probably applied here. The expense of operating the business was incurred jointly for the merchandise in Group 1 and for that in other groups and an advantage was gained by having the expenses spread over the range of products even though market conditions did not make it practicable to charge the same percentage rate of expense to all items.

The method of remunerating salesmen by salaries and commissions based on quotas also is not raised as an issue. The policy which the company followed was consistent with its program of emphasizing the sale of high-margined goods. The system of records of salesmen's accomplishments likewise is not opened up for discussion here.

On the major question of the desirability of keeping records of customers' purchases classified by merchandise groups, the company's estimate of the expense that was involved indicated that the expense would not be so high as to weigh heavily against the adoption of the plan. In using such records, there was a danger that efforts would be made to force excess stocks of slow-moving merchandise onto the retailers. That danger, however, is inherent in any sales program that stresses the sale of goods on which unusually high margins are placed because they move slowly or are not in strong demand.

The customer records would be serviceable in showing where the application of the company's policy needed to be strengthened. They would show the customers that were particularly worth retaining and they might point to some customers whose purchases were not worth the expense of obtaining the orders. The information secured by means of such records should prove to be particularly serviceable as a guide for the wholesale firm in cooperating with manufacturers in promoting the sales of particular products; the records would reveal the districts in which a manufacturer's program of sales promotion needed most bolstering. The records also would indicate whether difficulties experienced in promoting the sale of individual wide-margin items were general or localized. If the difficulties were localized, they could be remedied by dealing with special conditions in the particular territories. If the difficulties were general, a question of merchandise policy, as to whether a particular article should be carried by the wholesaler or at

least whether sales emphasis should be placed upon it, would be raised.

The use of these records for answering requests of customers for special discounts is weighty only if one agrees with the soundness of a varying price policy. Special discounts to favored customers constitute a varying price policy. My personal opinion is that a one-price policy would be sounder and that, consequently, there should be no occasion to use the facts obtained from these records in dealing with requests for special discounts. If the company had a plan whereby each customer received extra discounts when he complied with certain conditions, then records of the type adopted would be necessary. In that event, however, all customers would be acquainted with the specific terms on which the discounts were to be granted, and requests for special consideration would not arise as in this case. The detailed records could be justified for carrying out an announced price policy but not on the grounds of dealing with special requests.

For applying pressure to increase the sales of items which yielded wide margins, these records could be expected to furnish valuable data. The danger of the misuse of such data already has been pointed out. From the standpoint of guidance in determining the plans for promoting sales in particular localities, the salesmen's records should have been sufficient. Little additional information would be gathered by means of these more detailed compilations. From the evidence offered in this case, I am skeptical as to whether a general conclusion can be drawn that departmentized records should be kept of the purchases of individual customers.

October, 1926 M. T. C.

Cleland Company[1]

WHOLESALER—GROCERIES

Sales Emphasis—*On Merchandise Yielding High Gross Margins.* The executives of the company, a wholesale grocery firm, were of the opinion that operating expenses had been reduced to a minimum and that future increases in percentage of net profit would have to be the result of an increased percentage of gross margin. The company, therefore, classified its merchandise by percentages of gross margin obtained and instructed its salesmen to emphasize the sale of items with high gross margins. Those items ordinarily were the ones with low rates of stock-turn.

(1924–1925)

Prior to September, 1924, the executives of the Cleland Company, a wholesale grocery firm, had endeavored to increase the company's percentage of net profit chiefly by effecting economies and increasing the efficiency of operations. The gross margin had averaged about 10% of sales, and total operating expense, not including interest on owned capital, about 8½% of sales. The executives decided that this expense percentage represented maximum effectiveness of operation and that future increases in percentage of net profit would have to be the result of an increased percentage of gross margin.

The Cleland Company was located in a middle-western city with a population of 110,000. The company's annual sales usually were about $750,000; its average inventory, valued at cost, about $75,000; and its annual stock-turn approximately 9 times. The company sold medium-price merchandise. Sales under the company's private brand were negligible as compared with total sales. The company employed five salesmen, two of whom it paid commissions only and three of whom it paid both salaries and commissions. Commissions were determined as percentages of gross margins on sales. The stock records which the company maintained showed the quantity of merchandise in stock at the first of each week and, also, the quantity of merchandise ordered.

The company made no attempt to allocate expenses to lines of

[1] Fictitious name.

merchandise and did not departmentize its merchandise purchases, inventories, or sales. The president of the company believed that the departmentization of purchases and sales would have little value unless expenses were allocated accurately and that the accurate allocation of expenses to departments or lines of merchandise was impossible in a wholesale grocery company with annual sales as large as $750,000. The transfer of employees from one operation to another, for instance, made difficult the proper allocation of labor charges.

Since the company did not take monthly inventories by items and did not allocate expenses to items, the net profit obtained from the sale of any particular item could not be determined. The president, therefore, believed that the company, as a means of increasing its percentage of net profit, should increase its average percentage of gross margin by concentrating sales efforts on lines which yielded high percentages of gross margin. Most of the items with high gross margins had low rates of stock-turn as compared with the stock-turns of items which had low gross margins, such as sugar and nationally advertised staples.

The company decided to emphasize the sale of items which yielded high gross margins. In order to accomplish this, the company classified all items of merchandise into groups according to the percentages of gross margin obtained. Because of competition, the company sold merchandise in some portions of its territory on a lower gross margin than it did in others. In classifying the merchandise on the basis of gross margins, the company used for each item the lowest gross margin obtained on that item in any part of the territory. Each group of merchandise was numbered to correspond with the percentage of gross margin yielded by the items in the group. There were the following groups: 3, 6, 7½, 9, 10, 12½, 15, 17½, 20, 25, 30, and 35. Sugar was the only item in group 3, that is, the only item which yielded the company a gross margin of 3%. Group 6 included a nationally advertised brand of baked beans and all brands of evaporated milk which the company sold. Group 7½ included a nationally advertised brand of coffee, corn cereals, bulk oats, package oats, condensed milk, Mason jars, cleansers, and soap. Group 9 included butter, cheese, wheat cereals and others, buckwheat flour, pancake flour, puffed rice, puffed wheat, butter-beans, and mayon-

naise. Group 10 included soda, a nationally advertised brand of baking powder, apple butter, butterine, bouillon cubes, eight well-known brands of coffee, chocolate, crackers, hominy grits, sugar corn, food in powder and tablet form, molasses, syrups, two well-known cleansing compounds, matches, starch, and snuff.

All other items yielded the company gross margins of 12½% or more. Group 15, for example, included 51 lines of merchandise, among which were bulk coffee, all kinds of fish, olives, peaches, prunes, pickles, peas, mustard, rice, raisins, and sardines. Group 25 included such items as fig bars, figs, package fruits, citron peel, mincemeat, spices, nuts, bulk spaghetti, popcorn, shoe nails, paper, electric light bulbs, rope, blueing, clothespins, and tacks.

The company desired to obtain an average gross margin of 12% of sales for 1925. The salesmen, consequently, were to place the greatest sales emphasis on items which yielded gross margins of 12% or more. The company provided each salesman with a small loose-leaf notebook in which items of merchandise sold by the company were listed in groups according to the gross margins which they yielded. By referring to this book, the salesmen could determine the percentage of gross margin which the company was obtaining from their sales.

In order to encourage the salesmen to sell the items which had high gross margins, the company established a success rating. Each week, from four to six high-profit items were designated as those upon which special emphasis was to be placed during that week. During the week, all orders sent in by the salesmen were analyzed to ascertain what portion of each salesman's orders included sales of the items selected for special emphasis. Salesmen were rated according to their success in this undertaking; for example, a salesman who had sold one or more of the selected items to 75% of his customers received a rating of 75%. That week, he was designated as a 75% salesman; a salesman who sold one or more such items to only 50% of his customers was designated as a 50% salesman.

The company introduced this plan of emphasizing the sale of items with high gross margins in the beginning of October, 1924, and calculated the percentage of gross margin yielded by the sales of each salesman for that month. These percentages were used

as a basis for judging the percentages obtained in the following months. Exhibit 1 shows the percentages of gross margin obtained from the sales of each of the five salesmen from September, 1924, to March, 1925, inclusive. The company also calculated the percentages of gross margin obtained from sales made at the office. These sales included merchandise sold to competitors whose stocks were depleted.

During the four-month period September to December, 1924, each salesman increased the percentage of gross margin which the company was obtaining on his sales; the increases varied from 1.6% to 4.3%. Over the entire period September, 1924, to March, 1925, the salesmen also increased their percentages of gross margin, but the increases were not so large as for the shorter period, varying from .4% to 1.4%. The president of the company believed that the increases in percentages of gross margin obtained by the salesmen were the result of the sales emphasis which had been placed upon the more profitable items. He was of the opinion that the small decreases during the first part of 1925 as compared with December, 1924, were the result of general business conditions, total sales having decreased perceptibly. The president said that it was difficult for the salesmen to sell high-profit merchandise at a time, such as early 1925, when retailers were restricting purchases to that merchandise which was absolutely necessary for retail stock.

EXHIBIT 1

CHANGES IN PERCENTAGES OF GROSS MARGIN OBTAINED BY SALESMEN OF CLELAND COMPANY, SEPTEMBER, 1924–MARCH, 1925, INCLUSIVE

Salesman	1924					1925			
	Sept.	Oct.	Nov.	Dec.	Increase Sept. to Dec.	Jan.	Feb.	Mar.	Increase Sept., 1924, to Mar., 1925
1	9.0	10.1	10.4	13.3	4.3	10.7	10.7	10.0	1.0
2	9.8	10.7	11.0	11.8	2.0	11.7	11.4	11.2	1.4
3	10.0	10.7	11.7	11.7	1.7	11.2	10.6	10.4	.4
4	9.2	9.7	10.3	11.2	2.0	10.0	9.9	9.8	.6
5	9.5	9.7	10.7	11.1	1.6	9.4	9.2	9.9	.4
6*	10.4	10.0	10.8	10.7	.3	9.9	10.4	10.5	.1
Average	9.6			11.6	2.0			10.3	.7

*This item was based on sales made in the office, without specific selling effort, and was not credited to salesmen.

Exhibit 2

Monthly Sales and Gross Margins of a Typical Salesman, and of Cleland Company, September, 1924, to March, 1925, Inclusive

Merchandise Group Number	1924								1925					
	September		October		November		December		January		February		March	
	Sales	Gross Margin	Sales	Gross Margin	Sales	Gross Margin	Sales	Gross Margin	Sales	Gross Margin	Sales	Gross Margin	Sales	Gross Margin
3	$ 5,431	$ 162.93	$ 3,015	$ 90.45	$ 2,188	$ 65.64	$ 1,978	$ 59.34	$ 1,595	$ 47.85	$ 1,321	$ 39.63	$ 1,792	$ 53.76
6	389	23.34	288	17.28	451	27.06	332	19.92	422	25.32	387	23.22	429	25.74
7½	874	65.55	589	44.18	629	47.18	531	39.83	526	39.45	381	28.58	688	51.60
9	762	68.58	790	71.10	565	50.85	498	44.82	511	45.99	367	33.03	484	43.56
10	2,592	259.20	2, 44	224.40	2,005	200.50	2,231	223.10	1,874	187.40	1,869	186.90	2,096	209.60
12½	833	104.13	762	95.25	759	94.88	768	96.00	588	73.50	728	91.00	1,252	156.50
15	1,739	260.85	1,833	274.95	1,952	292.80	1,640	246.00	1,963	294.45	1,470	220.50	1,912	286.80
17½	496	86.80	541	94.68	355	62.13	434	75.95	378	66.15	328	57.40	382	66.85
20	559	111.80	458	91.60	313	62.60	1,175	235.00	165	33.00	185	37.00	131	26.20
25	166	41.50	182	45.50	186	46.50	853	213.25	173	43.25	87	21.75	117	29.25
30	225	67.50	139	41.70	92	27.60	158	47.40	64	19.20	65	19.50	72	21.60
35	118	41.30	83	29.05	92	32.20	111	38.85	72	25.20	49	17.15	66	23.10
	$14,184	$1,293.48	$10,924	$1,120.14	$ 9,587	$1,009.94	$10,709	$1,339.46	$ 8,331	$ 900.76	$ 7,237	$ 775.66	$ 9,421	$ 994.56
Total for Company	$49,744	$4,758.99	$47,451	$4,792.94	$38,067	$4,071.21	$41,786	$4,915.17	$42,069	$4,326.32	$35,216	$3,614.71	$38,112	$3,853.46

The president's opinion as to a general decline in sales of groceries during the first part of 1925 was borne out by statements issued by the Federal Reserve Bank in the district in which the company was located. On February 2, 1925, the bank reported that groceries were selling in fair volume but that, as normally was to be expected, the demand had been lighter in January than in December. In a statement issued March 2, 1925, the bank reported that in January sales of groceries had been 11.3% smaller than in December, 1924, and 0.1% smaller than in January, 1924. On April 1, 1925, the bank reported that sales in February had been 4.1% smaller than sales in January and 3.2% smaller than sales in February, 1924. The company's sales for January, 1925, showed an increase of $283, or approximately 0.7%, over the sales for December, 1924, in spite of the 11.3% decline in grocery sales in the general market, as reported by the bank. In February, however, the company's sales decreased $6,853, or 16.3%, while the general decrease in the grocery market for the month was only 4.1%.

Exhibit 2 gives by months for the period September, 1924, to March, 1925, inclusive, the total sales of the company, the company's total amount of gross margin, and the sales of a typical salesman by groups of merchandise, together with the amount of gross margin obtained on sales in each group. During the period the company's total monthly sales decreased 23% and the monthly gross margin decreased 19%. The typical salesman's sales of merchandise yielding a gross margin of 12½% or more increased from $4,136 in September, 1924, to $5,139 in December, 1924, although his total sales were $3,475 less in December than in September.

Commentary: The company had reached the conclusion that its expenses were reduced to a minimum and that the only way to improve its net profit was to increase the sale of merchandise which yielded relatively high gross margins. Although no basis is furnished for judging the soundness of the company's conclusion that this was the only means by which net profit could be increased, it was a fact that the company's total expense, in ratio to net sales, was below the average for wholesale grocers. Its total expense, exclusive of interest on investment, amounted to about 8½% of its net sales. The average total expense, including interest, for 173 wholesale grocers with similar vol-

umes of sales in 1923 was 10.6%.[2] The common figure for interest was 1.5%. By deducting 1.5% from 10.6%, therefore, a figure of 9.1% is obtained for comparison with the Cleland Company's figure of 8½%. The company's rate of stock-turn was high, approximately 9 times a year, as compared with 6 times for the group of wholesale grocers just referred to. The company's rate of gross margin, 10%, was below the average, 11.3%. Hence, an increase in gross margin appeared to be the readiest means for enhancing net profit.

The case, in its broader aspects, raises the question as to the advisability in a typical wholesale business of attempting to concentrate sales effort on the lines which yield high gross margins. So far as the evidence in this case goes, it does not promise success for the policy. For the first few months, the rate of gross margin in percentage of sales increased. Then both the rate of gross margin and also the amount in dollars fell off. The falling off in the amount of gross margin in dollars apparently was caused largely by the decline in sales. In view of the facts stated, there is no indication that expenses were reduced materially, nor did the company expect to be able to reduce expenses. The policy, therefore, apparently must have yielded a smaller net profit in dollars than previously had been secured.

The decline in sales and in gross margin during the first part of 1925 may have been caused by seasonal fluctuations or by general business conditions, as the president thought. If that is the explanation for the experience during the first three months of 1925, it is equally reasonable to attribute the apparent success of the policy during the last three months of 1924 to the effect of the holiday period on the demand for fancy groceries.

On general principles, it is to be pointed out that the lines which yield a high rate of gross margin usually have such a margin placed upon them because they tend to move slowly and are hard to sell. The policy of concentrating sales efforts on such merchandise is likely to cause the neglect of other items which sell more readily even though they yield smaller gross margins in percentage of sales. Such seems to have been the result in this instance. As was pointed out in the commentary on the Pulitzer Company case,[3] furthermore, the principle of joint cost operates here. This means that it is desirable for a wholesale firm with a business of this type to maintain its volume of sales of low-margin, staple goods to bear as much expense as possible even though they contribute a smaller percentage of net profit. Inasmuch as the Cleland Company's high-margin lines probably were made up

---

[2] Bureau of Business Research, Harvard University, Bulletin No. 40, *Operating Expenses in the Wholesale Grocery Business in 1923,* p. 22.

[3] See page 188.

largely of goods which moved slowly, the retailers were reluctant to increase purchases of such merchandise and their patronage for other goods was not stimulated.

The policy of concentrating sales effort on high gross margin items did not take into account adequately the nature of the demand for such merchandise. The exertion of greater sales effort on the retailers did not necessarily increase their sales to consumers. Yet it was only by increasing the sales to consumers that such a policy could long yield success. In so far as an increase in the wholesaler's sales reflected merely an increase in the volume of merchandise on retailers' shelves, no progress in solving the company's problem had been made, for subsequent purchases by the retailers would be lessened and greater sales resistance engendered among the retailers who had overstocked their stores on wide-margin, slow-moving merchandise.

If the merchandise which bore a high gross margin had included chiefly goods which bore the firm's private brand, then the firm would have been in a position to undertake a program of sales promotion for influencing consumers.[4] That, however, would have presented a different set of circumstances from those which obtained in this case.

It is proper, of course, for a wholesale firm to expect each of its salesmen to maintain a suitable proportion between the sales of low-margin and high-margin lines, and the experience of the Cleland Company indicates that several lines with margins above the average deserved greater sales efforts than previously had been bestowed upon them. Provided the company had a good selection of merchandise, its problem was one of sales management involving the establishment of standards and the supervision of individual salesmen. The company could not have increased its net profit permanently merely by taking gross margin as an index to the lines to stress. So far as the evidence in this case goes, it leads to the conclusion that the policy of concentrating sales effort on high-margin lines is not likely to yield higher net profit for a typical wholesale firm.

October, 1925 M. T. C.

[4] See Menton Company, page 134.

Courtenay Company[1]

CHAIN STORES—GROCERIES

Sales Emphasis—*Store Managers' Commissions as Means of Directing.* The company, which operated 250 grocery stores, paid its store managers salaries and commissions on sales. It was proposed that, as a means of increasing sales of lines with wide gross margins, the company should pay store managers commissions on net profits rather than on sales. The company decided not to change its method of compensation, believing that use of the plan proposed would tend to encourage sales practices that might antagonize customers.

(1923)

The Courtenay Company, which operated 250 grocery stores in and near Cleveland, Ohio, had experienced difficulty in persuading its store managers to concentrate their efforts on the sale of the most profitable lines of merchandise. This difficulty was attributed by several of the executives to the existing method of compensation of store managers; in 1923, consequently, consideration was given to the advisability of adopting a new plan.

Under the plan in use, each store manager received a weekly salary of $30 or $35, plus an amount equal to 1% of the gross sales of his store in that week. When the company first was organized, in 1906, each store manager had received a straight salary; this method of payment, however, soon had been superseded by the salary and commission plan in an effort to induce managers to strive for increased sales. For a few months in 1918 a plan had been tried under which each store manager received no fixed salary, but a commission of 7% of his net sales, out of which he paid the wages of all his assistants and secured his own remuneration. This plan had failed, chiefly because managers in new stores became disgruntled as a result of inability to earn sufficient incomes, and the salary and commission plan had been resumed.

Sales were for cash only; they varied from $350 per week in new stores to $2,500 a week in well-established stores, with the average at approximately $700 a week. Bread, staple fruits, and dry vegetables were sold in addition to the usual varieties of

[1] Fictitious name.

staple groceries. Canned and packaged goods were stocked under the Courtenay label and also under manufacturers' brands, several of which were nationally advertised. It was stated that more than one-half the company's gross margin in dollars and cents was realized on approximately one-quarter of the total sales volume; that over the period of a year, for example, no profit was made on butter or sugar, and that the profit on eggs and bread was negligible in amount. The gross margin on nationally advertised products was said to be comparatively small; occasionally those products were used as sales leaders, and at such times were sold approximately at cost. The largest margin was realized on merchandise bearing the Courtenay brands; that merchandise was said to be equal in quality to nationally advertised food products, although lower in price.

The 250 stores of the Courtenay Company were grouped into 2 territories, each of which was in charge of a sales manager controlling 6 district superintendents. Each superintendent supervised from 15 to 25 stores, according to their accessibility; ordinarily he made daily visits to each store. The sales managers hired all the employees. The superintendents, all of whom had been promoted from positions as store managers, were paid salaries of from $75 to $100 a week, according to ability and length of service. Although in each of a few stores the manager was the sole employee, in a majority of instances each store had at least one full-time assistant.

The buying for the company's stores was centralized, and two deliveries were made weekly to each of the stores from the company's warehouse in Cleveland. The company operated its own bakery, which supplied fresh bread daily to the stores. Retail prices for all goods were established at the central office, and merchandise sent from the warehouse was charged to the stores at both cost and retail figures, but was billed at retail only. A perpetual inventory was maintained at the central warehouse. Each store manager was held responsible for all merchandise that he received and for all the cash that he received from sales. A retail book inventory figure for each store was arrived at weekly at the central office by subtracting the store's net sales for the week from the total retail value of all merchandise sent

to the store during the week plus the retail inventory figure for the beginning of the week.

Physical inventories, which provided a check on the book inventories, were taken at retail by a special crew of three men from the central office. In a store in which a new manager recently had been placed in charge, a physical inventory was taken every two weeks; in most other stores a physical inventory was taken monthly. In a few stores in which the managers had been with the company for several years, a physical inventory was taken only once in three months. Net profits were calculated quarterly for each store by valuing the physical inventory at cost and distributing the warehouse and general administrative expenses among all the stores. The average net profit was 3% of net sales.

In deciding whether to change the existing method of compensation for store managers, the executives of the Courtenay Company gave serious consideration to a plan in use by the Monmouth Company,[2] a company which operated 100 stores in another city with average weekly sales per store of about $2,500. The store managers and other employees of the Monmouth Company received weekly salaries, which for the managers ranged from $40 to $50, and in addition shared in the net profits. The managers hired the store employees, with the approval of the superintendents, and used their own discretion in granting credit to customers.

Under the plan used by the Monmouth Company, merchandise was billed to each of the stores from the central warehouse at two prices, the retail price and the so-called wholesale price. Theoretically, that wholesale price was the cost of the merchandise plus all overhead expenses, including the salaries of executives, incurred upon the merchandise up to the time that it was received at the store. The wholesale prices were not determined on an exact basis, however, but each article was charged with such share of the overhead expenses as the buyer from experience deemed reasonable and practicable. As a matter of practice it had proved inadvisable to charge sugar, eggs, butter, condensed milk, and other articles having low gross margins with their proportionate shares of the overhead expenses, lest store managers be forced to sell those articles at an apparent loss.

[2] Fictitious name.

A physical inventory at wholesale prices was taken at each store every six months by an inventory squad from the central office; the net profit for each store was computed at the same time. The gross margin of a store represented the difference between the value of the merchandise sold, priced at wholesale, and the value of that merchandise priced at retail. From this gross margin the salaries of all store employees, and all other direct store expenses, were deducted in order to arrive at the net profit, which usually averaged about 3% of net sales.

According to the Monmouth Company's plan, a division of profits took place at the end of each six months' period. At that time the senior salesman in each store received 10% of the store's net profit for the period, the second salesman 5%, and the cashier 5%; the delivery or order boy usually was given a bonus of $5. The remaining profits were divided equally between the store manager and the company. Thus, in a representative store having sales for six months of $60,000 and a net profit for the period of $1,800, the manager's share of the profits would be $717.50. This plan had been in operation for 10 years and apparently had been successful.

It seemed possible to the executives of the Courtenay Company that the adoption of a profit-sharing plan similar to that used by the Monmouth Company would provide a direct and effective incentive to managers to sell profitable merchandise and to operate their stores in a competent manner. The result of paying a commission on sales was that the managers invariably devoted their efforts to the merchandise which sold most readily, such as the nationally advertised products. If the company adopted a profit-sharing plan it would be necessary to decide whether store managers should be expected to bear a share of any losses which occurred, as, for example, in times of rapidly declining prices. It was questioned, furthermore, whether the plan was advisable from the point of view of building up a permanent business. Such a method of compensation could be expected to encourage store managers to build up the sales of products bearing the company's private brands, since those items had the large gross margins, but it was asserted that women usually had preferences for specific brands and were inclined to resent being influenced unduly in making their purchases.

The Courtenay Company decided not to make any changes in its plan of compensation for store managers.

Commentary: The company's decision not to change its method of paying its store managers was supported chiefly, according to the statements in the case, by the reason that the use of a commission on net profit would have tended to encourage sales practices that would have antagonized customers. There was also the risk that dissatisfaction might have been occasioned among the managers by whatever methods were adopted for determining net profit. In figuring net profit it would have been necessary to prorate the general management and warehouse expenses to the individual stores on some arbitrary basis, for this was a joint-cost enterprise. Because such a method inevitably would have been arbitrary, it probably would have been adversely criticized by at least a portion of the store managers. In this particular instance, however, a substantial part of the expense was direct expense for each store. Therefore, the problem of arriving at a fair figure for total expense to be deducted from the gross margin to show the net profit was much less troublesome than in those businesses where all expenses must be prorated on an arbitrary basis. The use of the commission on net profit as a form of incentive payment could not have been rejected solely on this ground.

Inasmuch as most of the operating expenses of a store were beyond the control of the store manager, the major effect of the use of a commission on net profits would have been to encourage the store managers to attempt to stimulate aggressively the sales of wide margin lines. The dangers of that practice in this instance were analogous to certain of those stated in the comments[3] on the Cleland Company case. The sales of staple lines, as was pointed out in connection with that case, might easily have suffered from neglect, with the result that the company's aggregate net profits would have been affected adversely. Furthermore, the company's apprehension that resentment would be aroused among customers by efforts to substitute wide-margin lines for staple articles or to press the purchase of private-brand goods was well founded.

The experience of the Monmouth Company which is cited in this case did not constitute a precedent for the Courtenay Company. The Monmouth Company had fewer stores with a larger average volume of sales per store. The higher salaries of the Monmouth Company's store managers indicated that those managers had greater ability than the Courtenay Company's store managers and could be relied upon to use more discretion in promoting the sales of wide-margin goods. The

[3] See pages 196 ff.

acceptance by the Monmouth Company's store managers of that company's methods of arbitrarily prorating expenses to the various lines of merchandise reflects the confidence which those managers had in the fairness of the executives. It does not prove that the same methods would yield equally satisfactory results if used by another company where the relationships between the store managers and the company's executives were not on so firm a foundation.

So far as the Courtenay Company was concerned, its method of paying its managers base salaries with a small commission on sales gave an incentive to industry, was easily understood by the managers, and was simple to administer. It is unlikely that the substitution of a commission on profits for the commission on sales would have yielded appreciably better results.

April, 1926 M. T. C.

Garry Company[1]

CHAIN STORES—FRUIT SYRUP

Merchandising—*Selection of New Brands of Merchandise.* At monthly meetings of the store managers employed by the company, which operated 118 stores selling meats and groceries, the demand for new brands and for new products was discussed. The company had decided that, unless a substantial demand for the article had manifested itself to the store managers, a new brand or a new product ordinarily was not to be purchased.

Merchandising—*Introduction of New Product in Chain Stores.* A chain grocery store company was asked by a company manufacturing fruit syrup to introduce a new syrup product in its stores. Although the chain store company ordinarily did not purchase a new article until a substantial demand had manifested itself among the stores' customers, the fact that the article was being sold successfully in other cities, the apparent merits of the article, the protection which the manufacturer agreed to give against spoilage, and the price concessions offered, led the chain store company to purchase a supply of the syrup.

(1924)

In May, 1924, the purchasing agent of the Garry Company, which operated 118 retail stores selling meats and groceries, received a favorable offer of fruit syrup from the A. D. Vinton Company,[1] which recently had begun to manufacture that product. It was a general policy of the Garry Company not to stock a new item or a new brand of merchandise until a definite demand for that item or brand had arisen among the store's customers.

Most of the Garry Company's stores were located in the District of Columbia. The warehouse and central office were in the city of Washington. Approximately 600 different items were carried in stock at the warehouse; almost all merchandise sold by the stores was delivered by trucks from that warehouse.

Control of the stores was centralized. The company divided its territory into 6 districts, in each of which it operated approximately 20 stores. For each district there was a district manager, who was responsible to the executives at the central office. The district managers had general supervision of merchandising meth-

[1] Fictitious name.

ods, arrangement of stocks, and window displays, for the stores in their respective districts. On the records at the central office the merchandise sent to the stores was charged to them at retail prices. Each store manager sent daily to the central office a statement of the merchandise sold and the money deposited in the bank during that day. The difference between the merchandise charged to a store and the store's sales indicated the store's current inventory at retail prices. Physical inventories were taken monthly under the supervision of the district managers.

A meeting of all the store managers was held once each month, and a meeting of all the district managers was held once each week. The purchasing agent, who also was a senior executive of the company, presided over both types of meetings. One of the questions discussed at those meetings was whether the demand for various brands and items of merchandise was strong enough to justify the company in stocking them. For instance, whenever a new brand of groceries was put on the market by a manufacturer, the purchasing agent asked the store managers whether any customers had demanded the brand by name or had demanded merchandise of a similar character without specifying the brand. Ordinarily, unless at least half the managers stated that some of their customers had asked for goods of the particular brand in question, the company did not stock that brand. Occasionally, when there was a demand for merchandise of a particular type but of no specific brand, the purchasing agent placed in stock what he considered the most satisfactory available brand of the type of goods demanded.

At the first meeting of the store managers which was held after the Garry Company received the offer of fruit syrup from the A. D. Vinton Company, the purchasing agent asked the store managers if customers had called for fruit syrup, and, if so, whether they had asked for the Vinton brand. Less than 25% of the 118 managers reported any demand for fruit syrup, and only about 10% had any customers who had asked for the new syrup by name.

The manufacturer's list price for the fruit syrup was $4 a case, with trade discounts of 15% and 5% and an additional discount of 10% for payment within 10 days. In addition, the manufacturer customarily offered to give 1 case free with every 20 cases

purchased, a practice commonly termed a "free deal." In its offer to the Garry Company, however, the A. D. Vinton Company proposed to give 1 case free with each case purchased, provided the Garry Company purchased 120 cases. According to the terms of the manufacturer's offer, the Garry Company, by placing an order for 120 cases, would receive 240 cases at a net cost of $383.72. After the initial purchase, sales to the Garry Company would be made on the manufacturer's usual terms. The manufacturer agreed to recompense the company for any spoilage that occurred.

The syrup was put up in 8-ounce glass jugs, 12 of which constituted a case. The syrup was used primarily for flavoring ice-creams and for making cold beverages. Consequently, the chief demand for it would come in the summer. The purchasing agent of the Garry Company compared the Vinton syrup with similar syrups then on the market and decided that it was superior to the others in quality. The prices of those other syrups were about the same as the usual price of the Vinton syrup.

The new syrup had been sold successfully in New York City and in Philadelphia. So far as the purchasing agent of the Garry Company knew, no fruit syrups of any brand were being sold in Washington. It was the A. D. Vinton Company's plan, however, to attempt to have Vinton fruit syrup stocked by every Washington store in which that merchandise would be appropriate. The manufacturer also planned to insert semiweekly advertisements in one Washington newspaper for two months after the syrup first was placed on sale in that city.

The purchasing agent of the Garry Company was convinced that competitors of the Garry stores would stock the new syrup. He expected them to sell the item at 35 cents a jug. If the Garry Company sold at the same price, its gross margin on the first order of 120 cases would be approximately 60%. In its offer, the A. D. Vinton Company had specified that the Garry Company should give one jug of the syrup free to each store manager. The purchasing agent estimated that in the warm season, which in Washington lasted at least 4 months, the Garry stores could sell 600 cases of the fruit syrup. The company's second and subsequent purchases would be in lots of from 40 to 100 cases, and on these purchases the company's gross margin would be 27%.

The company had computed no average gross margin for all the lines which it sold. On new kinds of merchandise and new brands, it tried to maintain a gross margin of at least 33⅓%. The gross margin on canned goods was about 25%; on such lines as baking powder, 20%; and on sugar, 10%. The stores' expenses varied from 14.5% to 16% of sales.

Although it was contrary to the company's policy to purchase merchandise before a substantial demand for that merchandise had arisen among the customers of the stores, the purchasing agent decided to accept the offer of the A. D. Vinton Company. The Garry Company advertised the syrup to some extent in local newspapers and featured it in window displays. The retail price decided upon was 35 cents a jug. From May to the latter part of August, 1924, the stores sold 400 cases of Vinton syrup.

Commentary: In this particular instance, the Garry Company's departure from its customary practice of purchasing only after demand had arisen, is not of especial significance. The amount involved in the purchase of the fruit syrup was small. The company was protected against loss from spoilage. The terms of purchase offered a chance to secure an unusually large rate of profit on the transaction. And the fact that the syrup was selling successfully in New York and Philadelphia indicated that it was likely to be acceptable to consumers in Washington.

From the standpoint of a manufacturing company which has the task of marketing a new product, this case is suggestive. In this instance, the manufacturer had a product for which the demand was highly seasonal. That circumstance impelled speed in introducing the product in a new market; little effective attention among consumers, and hence among retailers, could be attracted before the season opened or after it had closed. To realize the benefits of the latent demand, the manufacturing company had to have its product available for purchase in numerous stores as soon as advertising was begun in a particular city. A deferment of purchase of such an article by a consumer would result in an irreparable loss in sales, for deferment in purchase implied deferment in consumption. By selling to a chain store company with 118 stores, the manufacturer quickly could enter the market on a substantial scale. The Vinton Company obviously decided that the benefits to be gained from such assistance were worth paying a premium for. It would be necessary to have many more facts available, nevertheless, before conclusions could be ventured safely as to the full merits of the plan from the manufacturer's standpoint.

From the standpoint of chain store management, this case furnishes a significant illustration of methods of controlling the selection of new brands and new articles in order to avoid heavy inventories and accumulation of stocks of unsalable goods. The plan which the Garry Company followed was conducive to the maintenance of a high rate of stock-turn. It is to be noted that the Garry Company's method of selecting new merchandise showed that the company's object primarily was to supply demand rather than to stimulate demand.

March, 1926 M. T. C.

TRURO & COMPANY[1]

DEPARTMENT STORE—ALUMINUM KITCHEN WARE

MERCHANDISING—*Substitution of One Nationally Advertised Brand for Another in Retail Store.* A department store, when a firm manufacturing a nationally advertised line of aluminum kitchen ware made the continuance of the discount terms which it had been allowing retailers conditional upon the retailer's purchasing a specified volume annually, stocked a competing line and practically discontinued selling the first line. Because of the popularity among consumers of the line which it had discontinued, the department store several years later considered restocking that line.

MERCHANDISING—*Stocking by Retailer of Goods Sold from House to House by Manufacturer.* The buyer for the house-furnishings department of the company's department store objected to stocking a line of nationally advertised aluminum kitchen ware because of the manufacturer's plan of direct selling. The manufacturer not only sold to retail stores but also employed canvassers to sell from house to house. Those canvassers sold only articles which were not carried by the stores. It was the buyer's opinion that customers often came to the stores which carried that manufacturer's goods to buy articles shown them by the canvassers and were disgruntled because the stores did not have the desired merchandise.

(1922)

In the spring of 1922 John B. Truro, merchandise manager of the department store operated by Truro & Company, learned that several customers had been unable to secure certain aluminum kitchen-ware products of the Moseley Company[1] in the house-furnishings department of the store. The buyer for the department reported that the store was carrying only a few items in the Moseley line and was concentrating sales effort on the aluminum kitchen ware manufactured by the Luff Company.[1] In view of the popularity of the Moseley ware, the question arose as to whether the store should substitute the Moseley line for the Luff line or whether it should carry both lines.

The department store operated by Truro & Company was located in an Ohio town with a population of slightly less than 50,000. The store sold a complete line of women's, misses', and children's ready-to-wear garments and accessories, men's furnish-

[1] Fictitious name.

ings, furniture, floor coverings, household goods, draperies, toilet goods, dress goods, dry-goods, and notions. Its customers consisted mostly of the families of the more highly paid workers in near-by steel mills, machine shops, and rubber factories. The house-furnishings department sold china, glassware, kitchen furnishings, household hardware, wooden ware, refrigerators, and trunks. Sales of aluminum ware, which were approximately 5% of the total for the department, amounted to about $3,000 a year.

The buyer for the house-furnishings department explained that in 1913 he had stocked the full Moseley line and that it had proved popular. At that time the Moseley Company had quoted retailers list prices less 33⅓% and 10%. In 1917, however, the Moseley Company had decided to allow the additional 10% discount to no retail store that did not buy at least $5,000 worth of Moseley goods a year. At that time the purchases of Truro & Company from the Moseley Company had amounted to only about $2,500 a year. In accordance with its new policy the Moseley Company had refused to continue its former terms to Truro & Company. The buyer thereupon had undertaken to find another supplier. He had learned that the Luff Company was making a line of aluminum which in quality equaled that of the Moseley Company and which was sold to retailers at prices permitting a mark-up of 40% of retail selling prices. He had, therefore, gradually substituted the Luff line for the Moseley line. Mr. Truro was of the opinion that it might be well to restock the Moseley goods, and he instructed the buyer to get complete information on both the Moseley line and the Luff line. The buyer reported that the utensils made by the two companies were practically identical in weight, wearing quality, and retail prices. The Luff Company, he said, had shown more initiative in adding improvements to its line, but the Moseley Company had been quick to copy those improvements, so that its line was at all times almost as up-to-date as that of the Luff Company. Neither company granted exclusive agencies to retail stores and neither placed any limit on the number of items which a store should stock or upon the amount of goods which a store must buy in order to carry the merchandise. The Luff Company quoted its prices net, and in general those prices were the same as the list prices of the Moseley Company less 40%. The buyer said that although he

had obtained no promise, he thought that the Moseley Company would be willing to allow him 33⅓% and 10% off list prices, waiving the requirement as to annual volume of purchases.

The Moseley Company not only sold through retail stores but also directly to consumers by means of house-to-house canvassing. It advertised its products extensively in magazines. The company's publicity methods had been so thorough at the time when aluminum ware was not well known that consumers had come to look upon the Moseley products as typifying products which were aluminum, and aluminum as a metal was popularly associated with the Moseley products as such. Its advertising and canvassing had enabled the company to maintain the reputation of its line from year to year, in spite of the fact that numerous competitors had entered the field. The buyer for Truro & Company admitted that his department had lost many opportunities to make sales as a result of the discontinuance of the Moseley line. The Luff Company sold only to retail stores.

The Moseley Company offered retailers items at special prices from time to time as leaders for sales events. The company selected those items and advertised them in magazines and in the newspapers of the towns where they were on sale. The retail prices for the special items, as well as for the regular line, were stipulated by the manufacturer and were stated on the display material sent with the goods. The retailers usually secured a gross margin of from 30% to 35% on the special items. The special items bore the Moseley Company's trade-marks just as did the merchandise sold at the usual prices. The Luff Company, on the other hand, manufactured a line of utensils designed especially for special-price sales. Those articles were of practically the same quality as the branded articles, but were left unbranded in order that retailers might be free to price them as they wished. The buyer for Truro & Company preferred this policy of the Luff Company to that of the Moseley Company. He did not like to have manufacturers dictate the prices at which goods in his department were to be sold.

The buyer was opposed to restocking the Moseley line because of the manufacturer's policy of direct selling. Salesmen of the manufacturer, he said, pointed out that the canvassers sold only items not carried by the stores and that their activities conse-

quently should not interfere with sales of retailers. In the buyer's opinion, however, the manufacturer's direct selling was objectionable for that very reason. Customers, he said, frequently saw the articles shown by canvassers but refused to buy from them, preferring to buy from retail stores. When these customers were unable to secure the articles desired from the stores, he said, they often were disgruntled. The buyer said also that restocking the Moseley merchandise might mean aggressive pushing of aluminum ware again and that his salespeople were tired of talking of the advantages of aluminum ware. He favored placing the main selling effort on enameled utensils, which yielded a larger gross margin than did aluminum ware. He admitted, however, that sales of aluminum ware could be increased.

COMMENTARY: This case serves chiefly to illustrate the influence of emotional motives on the policy adopted by a department store buyer. The Moseley line of aluminum kitchen ware had given satisfaction to customers and there was a substantial demand for that line from customers of the store who would not accept Luff ware as a substitute. No evidence was presented to prove that a gross margin of 33⅓% on Moseley ware was unprofitably low. Under such circumstances the buyer might have been expected, on rational grounds, to view Moseley ware favorably; yet he was opposed to resuming relations with the Moseley Company. His objections to the Moseley line apparently were based on the reduction in the gross margin in 1917 when the period discount plan was put into effect by the Moseley Company, the standardization of resale prices by the manufacturer even for special sales, and the house-to-house canvassing by the manufacturer. These reasons, at least as presented, do not afford convincing grounds for the buyer's attitude; they suggest rather an effort to disguise resentment.

July, 1926 M. T. C.

Milburton Brothers[1]

DEPARTMENT STORE—GLOVES

Merchandising—*Substitution of Private Brand for Nationally Advertised Brand.* In 1914 the firm offered women's silk gloves in its department store under the private brand which had been adopted for general use in the store. For five years the firm continued to carry also a nationally advertised brand of silk gloves, but substituted, in so far as possible, gloves bearing its private brand. In 1919 the sale of the nationally advertised brand was discontinued. Three years later, however, it was discovered that a strong demand for the nationally advertised brand continued and that numerous customers would not accept the private brand as a substitute.

(1922)

In September, 1919, Milburton Brothers decided to discontinue selling Hartwell[1] gloves, the only line of nationally advertised silk gloves which the store carried or had carried during a period of eight years. According to this decision all gloves sold in the glove department would bear the Milbro name, which had been adopted in 1913 as a private brand for the store. During the six years following the decision in 1913, merchandise bearing the Milbro name had been stocked in more than one-third of the departments of the store, and in practically every case it was deemed to have sold as well or better than the nationally advertised products with which it was competing.

In 1914, when the Milbro brand had been introduced in the glove department, 80% of the gloves sold were Hartwell gloves. The store's total purchases of silk gloves from the Hartwell Company in that year were somewhat over $50,000. By 1919 about 90% of the total sales of silk gloves were of the Milbro brand. In the fall season of 1918 and the spring season of 1919 the total purchases of Hartwell gloves were less than $5,000, or, roughly, 10% of what they had been five years earlier. Hartwell gloves were sold in several other stores which competed directly or indirectly with Milburton Brothers.

It was not known how many customers called for Hartwell gloves in Milburton Brothers' store, how many customers insisted

[1] Fictitious name.

upon that brand, nor how many of those who called for Hartwell gloves eventually took the Milbro brand. It was suspected that occasionally customers were antagonized by salespeople who showed them substitutes when the nationally advertised gloves were called for. It seemed better strategy for the salesperson to show, first, the gloves of the brand and quality asked for by the customer, and then to show similar ones of the store's own brand. By that method customers were not likely to think the salesperson dictatorial, but rather that a service was being rendered. It was apprehended, however, that some customers who were accustomed to buying Hartwell gloves would be lost if they were forced to go to another store to buy Hartwell gloves.

The relative costs and selling prices of Hartwell and Milbro brands in September, 1919, are indicated by the price of one representative style in each line. The Hartwell style Number 176 cost $15.50 per dozen, net, and sold for $2 per pair. The competing style of the Milbro line cost $15.50 less 7% for payment in 10 days, and sold for $2 a pair. In quality the two numbers presented some differences. The Milbro glove was made of heavier silk and was known to wear longer, but the workmanship of the Hartwell glove was such that it had a better appearance. The finger tips were more uniform and smoother than those of the Milbro brand, and the hem of the glove was finished with round corners and neater stitching. There was no difference in the clasps.

The decision to discontinue purchasing any nationally advertised gloves held in 1920 and 1921. All gloves bearing the Hartwell brand were disposed of in the regular course of business, and no new orders placed. The buyer, however, made an investigation during May and June, 1922, to determine how many customers called for the Hartwell brand and how many of them accepted the Milbro brand as a substitute. It was found that in the 45 days, 586 customers called for the Hartwell gloves. Of these, 86 refused to take the substitute and left the department without purchasing. The other 500 bought gloves of the store's own brand. It was feared that many of these 500 would not return to buy a second pair of Milbro gloves, but would go to stores which were known to carry the Hartwell line. In the fall season of 1922, therefore, the nationally advertised merchandise was

again stocked in small quantities. There was no change in the company's policy of pushing the sale of gloves bearing the Milbro brand.

COMMENTARY: The firm had succeeded in displacing the nationally advertised brand by its private brand of silk gloves. Whether it was a gainer thereby is a matter of conjecture, and the problem could be answered mathematically only by an analysis of the sales, expenses, and profits of the glove departments of several stores, one group of which had followed a policy similar to that of Milburton Brothers and another group of which had purveyed nationally advertised brands during the same period of time.

By substituting the private brand for the manufacturer's brand the store retained for itself all the good-will that attached to the brand on the gloves which it sold. The gross margin which it secured on the gloves bearing the private brand, as indicated by the typical figures cited in the case, was 39.9% of the selling price, whereas the gross margin for the nationally advertised brand was 35.4%. These advantages, however, do not prove that the store's example was worthy of emulation. The extra sales effort to effect substitution when the nationally advertised brand was called for must have increased selling expense, for more time was required to complete a sale. This extra selling expense partially offset the gain from the higher gross margin. Although the Milbro gloves were more durable they were less attractive in appearance than the Hartwell gloves, and appearance is a quality of primary consequence in the purchase of women's silk gloves.

The demand for Hartwell gloves in Milburton Brothers' store was strong even 2½ years after their sale had been discontinued. This suggests that the private brand was making slow headway in gaining recognition among consumers. The loss of sales because of the efforts to effect substitution was not negligible. The success of the store's policy, therefore, was not proved.

July, 1926 M. T. C.

Whiteside Company[1]

DEPARTMENTIZED SPECIALTY STORE—BOYS' CLOTHING

PRICING—*Simplification through Limiting the Number of Price Lines.* The company decided to reduce the number of prices at which boys' suits were sold in its departmentized specialty store. The executives recognized that use of a limited number of prices would necessitate the varying of percentages of mark-up and would lead to difficulty in meeting competitors' prices, but favored the plan because it would facilitate the selection of merchandise by customers as well as by buyers, promote careful merchandising, and encourage customers to buy goods at the higher prices, inasmuch as price intervals, and consequently differences between the quality of goods at two consecutive price levels, would be greater.

(1922)

The Whiteside Company operated a departmentized specialty store in which it sold men's and boys' shirts, underwear, hosiery, neckwear, and similar furnishings, and shoes, overcoats, and suits. In 1922 the buyer for the boys' clothing department proposed to establish a set of standard prices at which all boys' suits sold in the department would be marked. The buyer was convinced that a limited number of standard prices should be established for each class of merchandise sold in his department, but he proposed to experiment only with suits at first.

For six weeks the buyer kept a record of the boys' suits sold in his department at the various prices then prevailing, which ranged from $6 to $30. From that record he was able to determine the prices which seemed to be most popular with customers. From a consideration of both the apparent preference of customers and the manufacturers' selling prices, he concluded that the following eight standard prices should be established: $7.95, $8.95, $10.95, $14.95, $18.95, $21.95, $24.95, and $27.95. His plan was to adhere strictly to these prices in marking merchandise when it first was put on sale and also in repricing merchandise subsequently. He planned to purchase no merchandise, regardless of the value offered, unless it could be marked at one of the eight standard prices without the application of an abnormally large or small rate of mark-up.

[1] Fictitious name.

To indicate the rates of mark-up which he considered reasonable, the buyer prepared a buying guide which showed, for each of the eight standard prices, possible cost prices and the mark-up percentages which would be secured if merchandise purchased at each price were marked at the corresponding standard retail price. If the plan were adopted, the buyer proposed to carry this guide with him in the front of his order book.

Although the buyer's proposal was a departure from the store's existing methods of merchandising, the general manager was convinced that the idea had distinct merit and that the advantages, as described by the buyer, probably would outweigh the objections. He decided, therefore, that the plan should be adopted.

The general manager agreed that the use of a limited number of standard retail prices would facilitate customers' selections of merchandise and thus reduce the time required to make a sale. He believed that customers often were hindered in making selections by a confusing variety of merchandise displayed at numerous prices. He agreed, furthermore, that a larger interval between prices might make it easier to sell goods at the higher prices, since the differences in quality between goods at one price and at the next higher price would be more readily discernible than when a large number of slightly different prices were used. In addition, it seemed to him that a system of fixed prices would aid the buyer in selecting merchandise and in determining the selling prices for the suits after he received them. Finally, the general manager was of the opinion that the proposed system would enable the buyer to estimate his final gross margin with greater accuracy than under the existing system; it seemed that the system would encourage more careful merchandising, which, in turn, would reduce the necessity for mark-downs.

The general manager recognized certain disadvantages of the plan. Unless customers were shown merchandise at a wide variety of prices they might assume that assortments were small. If it used an inflexible price scale, the company would have difficulty in meeting competitors' prices. When mark-downs were taken they probably would be greater than under a system which did not limit the number of prices. The standard prices would make it necessary to allow the buyer to vary mark-up percentages

more freely than he had in the past, unless he were to be distinctly handicapped in the selection of merchandise.

At the end of six months the plan was operating successfully and the management was considering extending it to other merchandise in the store.

COMMENTARY: The standard price plan adopted by the company served automatically to simplify the line of boys' suits carried in the store. The price intervals were narrow enough to be fully satisfactory to customers in making a selection. With a larger number of prices and smaller intervals consumers were likely to be confused rather than helped in their purchasing. The simplification of the line could be expected to yield large enough economies to enable the store to offer values that would meet competition successfully.

This case illustrates one method of effecting simplification of lines in a retail store—by restricting stocks to a limited number of standard prices. The merit of the plan adopted by the Whiteside Company attaches to the result—simplification—rather than to the particular price scale chosen.

July, 1926 M. T. C.

Tasker Brill Company[1]

DEPARTMENT STORE—READY-TO-WEAR GARMENTS

PRICING—*Simplification through Limiting the Number of Price Lines.* For each of the ready-to-wear departments in its store, the company decided to establish a limited number of standard prices. This plan of standardization later was to be extended to other departments. The executives recognized that use of fixed prices might make it difficult to meet competitors' prices, might interfere with the purchase of merchandise at favorable prices, and might increase mark-downs. They expected the plan to reduce price competition within departments, to facilitate selection of goods by customers, thus accelerating sales, and to enable buyers to obtain price concessions from manufacturers.

(1922)

The executives of the Tasker Brill Company in 1922 concluded that too many selling prices were used in most of the departments of the store which the company operated. In the bathing suit department, for example, more than 60 prices were used. Ladies' coats were sold at more than 35 prices.

It was suggested that a limited number of standard prices should be established for each department. One of the most important advantages of price standardization, according to the merchandise manager, was the elimination of price competition within departments. A customer willing to pay approximately $50 for a coat, for example, would be less confused if shown coats in a variety of styles, fabrics, and colors at $50 than if she were shown fewer coats at each of a number of prices ranging from $45 to $55. If customers' selections were facilitated by the elimination of such price competition, the salespeople would be able to makes sales more readily. Fewer prices also would make it easier for the salespeople to familiarize themselves with the stock. Buyers, moreover, would go into the market seeking merchandise at definite prices, and might obtain concessions from manufacturers by explaining the necessity of securing merchandise which could be sold at the fixed prices.

On the other hand, standardized prices might be too inflexible. Competitors would be likely to sell at prices slightly lower than

[1] Fictitious name.

those adopted by the company. It seemed probable, however, that exceptions to the standard-price policy could be made so that competitors' prices could be met. Another objection raised was that buyers might be unable to purchase special offerings of merchandise at lower prices because there would be no standard prices at which it could be sold and allow a reasonable margin. The amounts of mark-downs, moreover, would tend to be greater with standard prices, since in each instance the price would be reduced to the next lower standard price rather than to an intermediate price. In one way this feature would be an advantage, because there would be no question about the price to which merchandise should be marked down.

In May, 1922, the company decided to standardize prices in its ready-to-wear departments and to extend the standard-price policy to other departments as speedily as practicable. In several departments, figures showing the number of garments sold at each price during the preceding three months were used as the basis for determining which prices should be made standard. In other departments, standard prices were selected on the basis of the experience of the buyers. In most cases the particular prices selected were thought to be unimportant, so long as the number was reduced.

For the ladies' coat department the following schedule of prices was adopted: \$22.50; \$25.00; \$29.75; \$33.00; \$38.00; \$45.00; \$55.00; \$65.00; \$75.00; \$85.00; \$98.00; \$115.00; \$135.00; \$150.00; \$165.00; \$175.00; \$185.00; \$198.00; \$225.00. The prices \$33.00, \$38.00, and \$45.00 were established to undersell coats marked by competitors at \$35.00, \$39.50, and \$49.50, respectively. The manager of the department wished to establish a volume of sales at the \$33.00, \$38.00, and \$45.00 prices and was convinced that the reductions below competitive popular prices would accomplish this end. The merchandise manager also attempted to make the intervals between prices proportional; for example, the difference between \$22.50 and \$25.00, the next higher price, was approximately the same percentage of that price as was the difference between \$75 and \$85 as a percentage of the latter price. Within a short time, four additional prices, \$49.50, \$59.50, \$69.50, and \$79.50, were added to enable the company to meet the competition of other stores which were selling coats at those prices.

In other ready-to-wear departments standard prices also had been determined upon according to the judgment of the buyers and merchandise managers, and later altered, if necessary, to meet competition. Custom frequently entered into the decisions as to prices to select. Standard prices differed for the various departments. In the blouse department, for example, the price $24.75 was used instead of $25.00, one of the standard prices for coats; this was done because the executives believed that a 25-cent differential on an expensive blouse seemed greater than the same differential on a low-price coat.

After standard prices had been in effect for a year, the merchandise manager was entirely satisfied with their use. For the ready-to-wear departments as a whole the value of the stock on hand had decreased 20%, sales had increased 5.1%, and the rate of stock-turn had increased from 3 times to 4.4 times for the period. The coat department showed a 30% reduction of stock, an increase of 0.4% in sales, an increase in the rate of stock-turn from 4.4 times to 7.3 times, and a 50% increase in percentage of profit. These figures were attributed largely to the standardization of prices, although the influence of other factors was recognized.

COMMENTARY: The plan adopted by this company for simplifying its lines had the same merits, in general, as the plan adopted by the Whiteside Company.[2] The reduction in the number of lines of ladies' coats, which was given as an example, was from over 35 prices to 19 prices, later increased to 23 prices. Although this reduction was substantial, it is not obvious that it was great enough; the reason given for putting in the $33 and $35 prices—to undersell competitors—is not convincing. Competitors would not be long in meeting that situation.

The arrangement of the price intervals, whereby the intervals became wider and wider as the price scale rose, was logical in so far as the principle was observed. Between $135 and $198, however, the plan of increasing the price intervals as prices rose was not carried out. The company emphasized price competition; hence the bulk of its sales must have been made in the lower segment of its price scale, for consumers do not generally desire to purchase high-price, distinctive merchandise in a store that constantly emphasizes "bargains" or stresses low prices. Under such circumstances the continuance of the high-

[2] See page 217.

price lines in the price scale served chiefly for trading-up[3] on the remainder of the lines. This result presumably could have been accomplished as well with fewer prices above $135.

In adopting a plan for the simplification of stocks by standardizing price lines, a retail merchant must attach importance chiefly to the determination of the number of lines and the price intervals, for the specific prices must be subject to modification whenever substantial changes occur in the general level of commodity prices.

July, 1926 M. T. C.

[3] See Badger Watch Company, 1 H.B.R. 420; commentary, 2 H.B.R. 525.

Herrington Company[1]

WHOLESALER—GROCERIES

Purchasing—*Reduction in Size of Purchase Orders to Increase Rate of Stock-turn.* As a means of increasing the rate of stock-turn, the company, a wholesale grocery firm, decided to reduce the size of orders placed with manufacturers. Ordinarily each order of merchandise would be limited to a one month's supply.

Merchandising—*Purchase of New Items Restricted to Increase Rate of Stock-turn.* As a means of increasing the rate of stock-turn, the president of the company, a wholesale grocery firm, instructed the buyers to purchase no new items without his approval. The president decided not to stock a new item until a substantial demand for it had been manifested.

Merchandising—*Increasing Rate of Stock-Turn by Simplifying Line.* As a means of increasing the rate of stock-turn, the company, a wholesale grocery firm, decided to reduce the number of competing lines which it carried and also the number of sizes in which it stocked the different varieties of merchandise.

Stock Control—*Method of Computing Stock-Turn for.* Because its inventories were unusually large at the end of the year and unusually small in the summer, the company, a wholesale grocery firm, decided that, for purposes of merchandise control, rate of stock-turn should be computed on the basis of inventories as of July 1 and December 31 instead of on the basis of inventories as of December 31 and January 1. Previously this latter basis had been used, with the result that the rate of stock-turn had appeared to be unduly low.

(1925)

The president of the Herrington Company regarded the figures of annual stock-turn as one standard by which to judge the progress of his company from year to year. In 1925 he computed the rate of stock-turn for the fiscal year ending December 31, 1924, to be 5.8, the lowest in the history of the company. The president deemed it essential that steps should be taken to increase the rate of stock-turn in 1925.

The Herrington Company was located in a middle-western city with a population of about 800,000. With the exception of coffee roasting, the company did no manufacturing. Its merchandise

[1] Fictitious name.

consisted of medium and high-price grades. The company sold about 30% of its merchandise under its two private brands which, for the most part, were placed upon its canned goods. The company's 18 salesmen called upon the 2,000 customers on an average of once a week.

The company did not departmentize its merchandise inventories, purchases, or sales, nor maintain any perpetual inventory records. A physical inventory ordinarily was taken biweekly, and the units of each item in stock were recorded in a stock book. From the physical inventory, the cost value of merchandise on hand was computed in the middle as well as at the beginning and end of each year.

In order to secure a high quality of canned goods to be sold under its private brands, the company purchased its year's supply in the spring of each year. Shipments of this merchandise began in August, and, ordinarily, all had arrived by the latter part of November. From that time until the latter part of August, inventories of canned goods steadily decreased.

Previous to 1920 the company's auditors had computed the annual rate of stock-turn by averaging the cost of the inventories on hand at the beginning and end of the fiscal year, and dividing the cost of goods sold during the year by that average inventory. In 1920 the president of the company had become dissatisfied with the basis of the stock-turn computation. Customarily, on December 31, the company had a larger inventory than at any other time, with the possible exception of November 30, whereas the inventory was reduced to a seasonal minimum during the summer months. The average of the inventories at the beginning and end of the year, therefore, yielded an inventory figure which, relative to the seasonal fluctuations in merchandise on hand, was unjustifiably high. As a result, the rate of stock-turn appeared to be lower than it actually was. An average of the January 1, July 1, and December 31 inventories would have given undue weight to the large inventories at the first of each year. In the president's opinion, it would have been equally unsound to have used the average of inventories taken July 1, December 31, and the following July 1. In the latter case, undue weight would have been given to the low inventory on July 1. For these reasons, in 1920 the president had decided to determine the cost value of the July 1 inventory and to average the July 1 and

December 31 inventories at cost each year as the basis for calculating the stock-turn figures to be used in formulating merchandise policies. For the income statements, however, the company auditors had continued to compute the stock-turn from the average inventories at the beginning and end of a year. The inventories on July 1 and December 31 of each year subsequently were as shown in Exhibit 1.

EXHIBIT 1

JULY 1 AND DECEMBER 31 INVENTORIES, HERRINGTON COMPANY, 1920–1924, INCLUSIVE

Years	Value of Inventories	
	July 1	December 31
1920	$138,662	$133,968
1921	75,653	104,466
1922	73,171	126,724
1923	80,997	98,412
1924*	139,096	194,426

*In January, 1924, the company had been consolidated with another wholesale grocery firm.

A comparison of the rates of stock-turn based on the average of the January 1 and December 31 inventories with the rates of stock-turn based on the average of the July 1 and December 31 inventories is shown in Exhibit 2 for the years 1920-1924, inclusive.

EXHIBIT 2

RATES OF STOCK-TURN BASED ON JANUARY 1 AND DECEMBER 31 INVENTORIES COMPARED WITH RATES BASED ON JULY 1 AND DECEMBER 31 INVENTORIES, HERRINGTON COMPANY, 1920–1924, INCLUSIVE

Years	Stock-Turn Based on Average of January 1 and December 31 Inventories	Stock-Turn Based on Average of July 1 and December 31 Inventories
1920	6.1	6.5
1921	5.5	7.2
1922	5.2	6.2
1923	5.8	7.3
1924	4.8	5.8

Both methods of computing stock-turn showed that the company had obtained, in 1924, the lowest rate of stock-turn in five years. To increase the rate of stock-turn during 1925, the president decided to adopt the following policies:

First, the company began to reduce the number of competing lines and the number of sizes in each variety which it carried. For example, two eastern spice manufacturers packed twenty-three varieties of spices in one-ounce, two-ounce, three-ounce, and four-ounce packages. The Herrington Company ordinarily kept in stock from three to four cases of each item, in each of the four sizes, of each manufacturer. Although sales were distributed fairly evenly between the four sizes, the president decided that one could be eliminated. As the one-ounce package sold at retail for 5 cents, and the two-ounce package at 10 cents, he believed that it was inadvisable to discontinue these sizes. Those who customarily purchased the three-ounce packages, however, probably would not object to purchasing a four-ounce package. For that reason, the company discontinued purchasing the three-ounce packages of both manufacturers. This resulted in a reduction in stock of nearly $275.

Each summer prior to 1925, the Herrington Company had sold the complete line of fruit syrups of each of four or five manufacturers. The president decided to carry a complete line of only one manufacturer during the summer of 1925. If the company's salesmen obtained any orders for the syrup of the other manufacturers, the Herrington Company could purchase the necessary items either from a competitor or through brokers. The president allowed the salesmen of the company to select the brand of fruit syrups which would be sold during 1925. The same procedure was adopted with respect to fly exterminators. Only one of the four brands of exterminators which had been sold during 1924 was to be sold during 1925.

The second policy which the president adopted in order to increase the rate of stock-turn was the reduction in the size of orders placed with manufacturers. Orders placed were to be limited, whenever possible, to one month's supply. So far as possible, this reduction was to apply to each item which the company carried in stock.

The third policy adopted was the reduction of new items purchased for stock. The president issued an order to buyers stating that they should not purchase a new item without his approval. In the first three months of 1925, no new item was purchased. The president believed that articles of merit probably had been

rejected, but he intended to wait until the demand for a new product clearly justified the company's stocking it.

Commentary: Neither of the methods of computing rate of stock-turn illustrated in this case was fully satisfactory. The purpose of these computations was to obtain an index as to whether the company was succeeding in holding down its investment in merchandise inventories to an amount that bore a proper ratio to the cost of the goods sold. Because of seasonal fluctuations, an average of the January 1 and December 31 inventory figures was greater than the average inventory during the year, and the use of that average in computing the rate of stock-turn, therefore, gave too low a figure for the rate of stock-turn. The use of the average of the July 1 and December 31 inventory figures was an improvement, since it more nearly approximated an average of the high and low inventory figures for the year. The latter method, however, yielded a misleading result whenever either the July 1 or December 31 inventory was abnormally small or abnormally large. Neither method, consequently, was a fully satisfactory substitute for an average of 12 monthly inventory figures.

It is to be noted that for both 1921 and 1923 the rates of stock-turn computed by the use of the average for July 1 and December 31 were materially higher than the rate shown for 1920, whereas when the average of the July 1 and December 31 inventories was used the rates appeared to be lower in 1921 and 1923 than in 1920. The reasons for this discrepancy could be determined only by an analysis of the monthly inventory figures for those years. Both methods showed a lower rate of stock-turn in 1924 than in the previous years. In a footnote it is stated that in January, 1924, the company had absorbed another wholesale grocery firm. Perhaps that had more to do with the decline in the rate of stock-turn than the officers of the company appreciated.

The general approach to the problem of reducing inventories by eliminating sizes and brands of merchandise that had an unprofitably slow rate of stock-turn was sound. The decisions as to the specific items to eliminate, however, seem to have been made without definite data regarding stocks, purchases, and sales of the various items. Under such circumstances it presumably was easy for errors of judgment to be made. The firm was working in the right direction, but with inadequate tools for controlling stocks. The method of stock control used by this company was typical of the methods employed by many other wholesale firms, and this case serves, therefore, to exemplify widely prevalent conditions.

May, 1926 M. T. C.

Covelle Company[1]

WHOLESALERS—GROCERIES

Stock Control—*Semimonthly Physical Inventories to Facilitate.* The company, a wholesale grocery firm which ordinarily took a physical inventory of many items but once a month, decided to take semimonthly physical inventories. The company expected the more frequent inventories to be helpful in controlling stocks and purchases, in increasing the rate of stock-turn, and in revealing slow-moving items of merchandise.

(1925)

Prior to 1925, when the inventory of any item was found to be low, the buyers for the Covelle Company, a wholesale grocery firm, had determined the size of the reorder primarily from their past experience. Inventories of portions of the stock were taken monthly, and of the remainder, twice each month. The president had observed, however, that the buyers frequently did not reorder far enough in advance those products which were inventoried monthly, and that the buyers were lax in learning of slow-moving products. Shortening of the period between inventories was contemplated, as a means of causing more effective purchasing.

The Covelle Company, which sold medium-grade staple groceries, did no coffee-roasting or tea-packing, and did not maintain a private brand. Annual sales were about $725,000, approximately 10% of which were of perishable products, such as butter and eggs. From 25% to 30% of sales were in broken packages. Approximately 5% of sales were made for drop shipment. The average inventory was about $88,000 at cost. With the exception of drop shipments, the company delivered in its own trucks all goods sold. The company purchased about one-half of its merchandise directly from manufacturers and one-half through brokers. The brokerage fees were paid by the sellers. The company's own trucks transferred about 5% of the purchases from the source to the company's warehouse; the remainder was delivered upon the company's railroad siding. Exhibits 1 and 2 compare the operating expenses of the Covelle

[1] Fictitious name.

Exhibit 1

Comparison of Operating Expenses of the Covelle Company with the Common Figures for All Wholesale Grocery Firms and for Only Those Firms with Net Sales Between $500,000 and $999,000 as Determined by the Harvard Bureau of Business Research*

Net Sales = 100%

Item	1922		
	Covelle Company	Common Figures, All Wholesale Grocery Firms†	Common Figures, Firms with Net Sales $500,000 to $999,000‡
Total Sales-Force Expense	2.82%	2.7%	2.7%
Advertising	....	.05	.06
Other Selling	....	.1	.08
Total Selling	2.82	2.9	2.8
Wages of Receiving and Shipping Force	3.03	1.3	1.3
Packing Cases and Wrappings	....	.05	.05
Outward Freight, Express, and Cartage	.56	.6	.6
Total Receiving and Shipping	3.59	2.0	2.0
Executive Salaries (including buying)	.84	1.1	1.1
Office Salaries	.89	.9	.9
Office Supplies and Postage	.13	.2	.2
Telegraph and Telephone	.04	.07	.06
Credit and Collection	....	.2	.2
Other Buying and Management	....	.1	.09
Total Buying and Management	1.90	2.6	2.6
Rent	.48	.5	.5
Heat, Light, and Power	.08	.07	.08
Taxes (except on buildings and income)	.13	.3	.3
Insurance (except on buildings)	.19	.2	.2
Repairs of Equipment	....	.05	.05
Depreciation of Equipment	.27	.2	.2
Total Interest	.71	1.7	1.7
Total Fixed Charges and Upkeep	2.86	3.0	3.0
Miscellaneous	.12	.2	.2
Losses from Bad Debts	.28	.4	.4
Total Expense	11.57	11.1	11.0
Gross Margin	11.89	11.6	11.5
Net Profit	.32	.5	.5
Stock-Turn	7.1 times	5.7 times	5.8 times

**Operating Expenses in the Wholesale Grocery Business in 1922*, Bulletin No. 34, pp. 26 and 28.
†Includes 442 firms, all those reporting.
‡Includes 153 firms.

Exhibit 2

Comparison of Operating Expenses of the Covelle Company with the Common Figures for All Wholesale Grocery Firms, for Only Those Firms with Net Sales Between $500,000 and $999,000, and for Firms with Stock-Turn of 7.0 Times and Over, as Determined by the Harvard Bureau of Business Research*

Net Sales = 100%

Item	1924	1923			
	Covelle Company	Covelle Company	Common Figures, All Wholesale Grocery Firms†	Common Figures, Firms, Net Sales $500,000 to $999,000‡	Common Figures, Firms with Stock-Turn of 7 Times and Over§
Total Sales-Force Expense	3.43%‖	3.24%‖	2.6%	2.7%	2.3%
Advertising	.....	.....	.06	.06	.....
Other Selling	.....	.....	.09	.1	.....
Wages of Receiving and Shipping Force	3.65	3.68	1.2	1.2	1.0
Packing Cases and Wrappings	.....	.....	.05	.04	.....
Outward Freight, Express, and Parcel Post	.....	.....	.25	.25	.....
Outward Truckage (including upkeep and depreciation)	.39	.63	.65	.65	.....
Executive Salaries (including buying)	.92¶	.88	1.0	.9	.....
Office Salaries, Wages, and Bonuses	1.0	.96	1.0	1.0	.....
Total Executive and Office Salaries	1.92	1.84	2.0	1.9	1.8
Office Supplies, Postage, and Stationery	.07	.09	.2	.2	.....
Telephone and Telegraph	.03	.03	.07	.06	.....
Other Buying, Management, and Office	.....	.....	.15	.15	.....
Rent	.53	.50	.5	.5	.5
Heat, Light, and Power	.08	.09	.08	.08	.....
Taxes (except on buildings, income and delivery equipment)	.14	.13	.3	.3	.....
Insurance (except on buildings and delivery equipment)	.20	.17	.15	.15	.....
Repairs of Equipment (except of buildings and delivery equipment)	.....	.....	.03	.03	.....
Depreciation of Equipment (except of buildings and delivery equipment)	.54	.28	.08	.08	.....
Total Interest	1.11	.83	1.5	1.5	1.2
Miscellaneous Expense	.05	.02	.2	.2	.....
Losses from Bad Debts	.19	.38	.4	.4	.....
Total Expense	12.33	11.91	10.6	10.6	9.9
Gross Margin	12.55	12.52	11.3	11.3	10.9
Net Profit	.22	.61	.7	.7	1.0
Stock-Turn (times a year)	6.8	7.2	5.9	6.0	.....

*_Operating Expenses in the Wholesale Grocery Business in 1923_, Bulletin No. 40, pp. 11, 22, and 42.

†Includes 501 firms, all those reporting.

‡Includes 173 firms.

§Includes 150 firms.

‖Includes executives' salaries.

¶Includes only buyers' salaries; executives' salaries included in Salaries and Wages of Sales Force.

Company in 1922, 1923, and 1924 with the common figures for various groups of wholesale grocery firms as determined by the Harvard Bureau of Business Research.

The company paid flat salaries to its 2 buyers and 4 salesmen. Each of its 500 customers, all located within a radius of 20 miles, was called upon once a week. The salesmen suggested to retailers improved methods of display and merchandising. Such assistance on the part of the salesmen, however, was not so extensive as the president of the company desired.

The Covelle Company did not departmentize inventories, sales, purchases, or expenses. In determining the amount of merchandise to be ordered the buyers relied on their 15 years' experience supplemented by the information obtained from a stock book. They depended solely on duplicate copies of orders or invoices of manufacturers for information as to the date of an order or the date on which shipment was received. The buyers usually purchased a maximum of one month's supply of any one item. In order to obtain quantity discounts offered by manufacturers, however, they occasionally purchased more than a month's supply. Approximately 5% of the company's purchases were pooled with those of its competitors in order to obtain quantity discounts. In that event, one of the wholesalers had the merchandise billed to him and he in turn rebilled the merchandise at cost to his competitors.

Prior to January, 1925, the Covelle Company had taken an accurate physical inventory of all items of merchandise in stock at the first of each month. In addition, a physical inventory of all fast-moving items, such as cereals and beans, had been taken in the middle of the month. The fast-moving items constituted from one-fourth to one-half the company's total stock. The units of stock on hand were recorded in consecutive columns in a stock book. A careful study of this book by the buyers was expected to furnish them with information as to the dates upon which to replenish the stocks of merchandise and as to which items were moving slowly. For example, a continuous stock of one or two cases of an item over a period of two or three months indicated that the item was not moving so rapidly as desired. Each month a list of all such items, called the dead stock, was made up. This list was given to the salesmen with instructions

to dispose of the stock. If salesmen were unable to dispose of it, prices were cut on the merchandise until sales were made.

The company's experience showed that inventories of all items on hand at the beginning of each month, with only the partial information obtained from the mid-month inventories, did not provide an accurate basis for repurchasing. The company often did not have in stock the staple merchandise ordered by customers. During 1924, such items had numbered from 15 to 18 daily. To have reported constantly to customers that ordered articles were not in stock would have affected unfavorably the company's sales. In consequence, it was necessary either to borrow from competitors or to purchase small quantities from brokers, who, in such circumstances, charged from 3% to 5% above the manufacturer's selling prices. The Covelle Company had arranged with two of its competitors to return borrowed merchandise when the company's supply arrived. One other competitor, however, would not lend merchandise but sold to the Covelle Company at prices 5% greater than those charged by manufacturers. Often, the competitors either did not have in stock the merchandise needed by the Covelle Company, or they did not have sufficient merchandise in stock to make a loan. Furthermore, it was necessary to send the company's trucks after such merchandise with the possibility of delaying regular delivery schedules. The company's net profit also was decreased whenever it was necessary to obtain merchandise from the company's competitor who charged the additional 5%.

The Covelle Company, therefore, wished to obtain some system of records which would provide more accurate information for merchandising the stocks. In January, 1925, the company decided to take twice a month a physical inventory of all items in stock. This record, as formerly, was to be entered in consecutive columns in the stock book. The company expected the semimonthly inventory to furnish information which would enable the company not only to decrease the number of items out of stock when ordered, but also to purchase twice a month merchandise that the company previously had purchased only once a month. In that way, the rate of stock-turn could be increased.

One further advantage to be obtained from the more frequent inventory was the ability to learn of slow-moving items sooner

than had been possible previously. While the company formerly had learned of a slow-moving item only after two or three months, the semimonthly inventory would furnish this information in a month or six weeks. The president believed that, as this semimonthly information became available for a long period, slow-moving items could be ascertained more promptly.

Although by March, 1925, the company had not had sufficient experience with the more frequent inventory-taking to draw permanent conclusions, the number of items out of stock when ordered had been reduced about one-half. The services of two men were required for between three-quarters of a day and one day to take the inventory.

COMMENTARY: From a comparison of the Covelle Company's operating figures with the typical figures for other wholesale grocers, it appears that the company's major problem lay in the high ratio of salaries and wages to sales. In 1923, for example, the company's total salaries and wages for all executives and employees, plus salesmen's traveling expense, amounted to 8.76% of net sales. For the entire group of wholesale grocery firms for which comparable data were available, the total of the same items amounted to 5.8% of net sales. The firm's other expenses were reasonably low, and its rate of stock-turn was above the average. This particular case, however, was concerned not with salaries and wages but with stock control.

The use of semimonthly inventories seems to have been aiding in the maintenance of a good rate of stock-turn. The success of the company in that direction, however, probably was the result fully as much of the good judgment of its buyers as of the inventory records, which apparently were not directly correlated with statistical records of sales and purchases. The question fairly may be raised as to whether the utilization of a balance of stock system of records would not have yielded savings in the time of the men employed in taking the semimonthly inventories and in the time of the executives using the data which would have more than offset the cost of such records. The method of stock control which this company was using was elementary, the chief reliance being placed upon the personal judgment of the buyers. The Covelle Company's method differed little from the method used by the Herrington Company.[2] The greater success of the Covelle Company in securing a high rate of stock-turn apparently must be attributed to its buyers.

May, 1926 M. T. C.

[2] See page 224.

Sneed Company[1]

WHOLESALER—GROCERIES

ACCOUNTING—*Use of Departmentized Merchandise Records.* For two years the company, a wholesale grocery firm, had prepared monthly records showing net sales, purchases, inventories, and gross margins by merchandise departments. The buyers for the company had made little use of this information and the executives concluded that the departmentized records should be discontinued, with the exception of the purchase records, which could be compiled readily.

SALES EMPHASIS—*On Merchandise Yielding High Gross Margin.* The departmentized merchandise records which the company, a wholesale grocery firm, maintained enabled it to determine the gross margins for each department and, hence, to place sales emphasis on merchandise on which high gross margins were obtained. The executives, however, decided that little could be gained by stressing sales of high gross margin merchandise and that records for that purpose were unnecessary.

ACCOUNTING—*Determination of Gain from Speculative Purchasing—(Commentary).* The commissions which the company, a wholesale grocery firm, paid its salesmen were based on gross margin computed as the difference between selling prices and cost of sales figured at the current market prices. The difference between gross margin so computed and gross margin based on actual cost of goods sold represented speculative gain or less, resulting from changes in market prices.

(1923)

The Sneed Company had operated, for more than two years, a system of accounting by which it departmentized purchases, inventories, and sales. The company expended slightly more than $1,000 annually in maintaining the records of the system. Late in 1922, the company was undecided as to whether the value received from the departmentization justified this expenditure.

The Sneed Company had annual sales of between $1,250,000 and $1,500,000. It sold medium-price merchandise, all of which, with the exception of about $75,000 annually, was distributed within a radius of 25 miles. It did no manufacturing other than coffee-roasting and tea-packing. The company had two private brands which it placed upon its canned goods, bottled goods, coffee, tea, and cereals. Sales of merchandise

[1] Fictitious name.

under the company's private brands comprised from 25% to 30% of total sales.

The company had about 2,000 customers; it employed 14 salesmen. Once a week, the salesmen called upon 80% of the customers; once every two weeks, upon the remaining 20%. Salesmen received as compensation 33⅓% of the gross margin resulting from their sales. The company had four buyers. These buyers acted in the capacity of sales managers for those products which they purchased.

The Sneed Company at no time had maintained stock records for the use of its buyers; nor had it kept purchase cards of any type. When the stock of any particular item was low, stock clerks advised the buyers of the fact. If a buyer did not recall when he had placed the last order for this merchandise, he consulted the record of duplicates of orders given to manufacturers. If he desired to ascertain the date of arrival of the last order of this merchandise and the quantity received, it was necessary for him to consult the files of invoices received from manufacturers. Ordinarily, a buyer decided from his past experience the size of order which he should place.

In April, 1920, the company had employed at a cost of $1,800 a firm of accountants to install a system of accounting which would departmentize merchandise purchases, inventories, and sales. These accountants had divided the company's merchandise into six departments, which they had designated as A, B, C, D, E, and F.

Department F originally had included all the teas which the company sold, both those nationally advertised and those packed by the company itself. In July, 1920, however, the company had changed this department to include only those teas which it blended and packed. Department E consisted of the coffee which the company roasted and sold under its private brands. Department D contained all brands of flour and grain products in bulk, such as Farina and chick-feed. The sales in this department had decreased sharply through 1920, and in February, 1922, the company had classified all flour and grain products as general groceries, and had changed Department D to include all merchandise which the company sold under its high-grade private brand. Department C consisted of both bulk and package sugar;

Department B, of all canned goods, with the exception of syrups, oils, and canned fish. Department A consisted of the remainder of the merchandise, or the line of general groceries.

After sales were made, a clerk in the office received the order blanks used by the company's salesmen and placed upon them, in addition to the selling prices, the cost-book cost of each item sold. The cost-book cost was the market cost at the time the merchandise was sold.[2] The gross margin between the selling prices and the cost-book costs served as the basis for the calculation of salesmen's commissions. The entire benefits of especially low-price purchases consequently accrued to the firm. The firm, likewise, was penalized for unskilful purchases at high prices. The order blanks were used as a basis for the allocation of sales between departments. It required the entire time of another clerk, who received an annual salary of about $1,000, to allocate between departments the monthly sales of the company's 14 salesmen. The company experienced no difficulty in allocating the monthly purchases in dollars for each department, as it easily ascertained them from manufacturers' invoices.

The company took a physical inventory every six months; it ascertained the value of intermediate monthly inventories for each department by bookkeeping calculations. The figured gross margin on monthly net sales, subtracted from the net sales, gave the cost-book cost of sales. The company obtained the closing inventory for the month by adding to the cost-book cost of merchandise in stock at the first of the month the net cost-book cost of purchases during the month and subtracting from this total the cost-book cost of sales. This inventory was inaccurate by the extent to which cost of merchandise as recorded at the time of sales for purposes of figuring salesmen's commissions differed from actual costs.

At the end of each month, a record was prepared which showed the total net sales in each department, total purchases, and gross margin. The ratio of gross margins to net sales also was calcu-

[2] That is, the cost-book cost of any item did not, over a period of time, represent the total cost of the merchandise as delivered in the company's warehouse. On the contrary, the cost-book cost was changed from time to time to correspond with important fluctuations in the replacement cost of the merchandise. For descriptions of this plan as used in other wholesale grocery companies, see Bureau of Business Research, Harvard University, Bulletin No. 55, *Cases on Merchandise Control in the Wholesale Grocery Business,* pp. 83, 84, 91, 124-128, 134, 190-192.

Exhibit 1

Total and Departmental Net Sales in Dollars, Gross Margin in Dollars, and Percentages of Gross Margin Obtained by Sneed Company, Monthly, January, 1921–December, 1922, Inclusive

1921		Total	A	B	C	D	E	F
January	Net Sales	$ 117,724	$ 48,421	$ 37,950	$ 15,498	$ 4,796	$ 9,432	$ 1,627
	Gross Margin	13,390	5,922	5,089	649	176	1,249	305
	Percentage of Gross Margin	11.37	12.23	13.41	4.19	3.68	13.24	18.77
February	Net Sales	$ 102,724	$ 49,130	$ 21,632	$ 18,800	$ 3,606	$ 8,125	$ 1,431
	Gross Margin	10,805	5,930	1,406	978	78	2,169	244
	Percentage of Gross Margin	10.52	12.07	6.50	5.20	2.18	26.70	17.04
March	Net Sales	$ 128,874	$ 55,207	$ 33,579	$ 24,270	$ 5,016	$ 9,143	$ 1,659
	Gross Margin	12,383	5,935	1,813	1,342	490	2,523	280
	Percentage of Gross Margin	9.60	10.75	5.40	5.53	9.77	27.59	16.86
April	Net Sales	$ 113,966	$ 50,277	$ 32,594	$ 17,069	$ 4,120	$ 8,406	$ 1,500
	Gross Margin	12,691	6,275	3,295	319	122	2,407	273
	Percentage of Gross Margin	11.14	12.48	10.11	1.87	2.95	28.64	18.22
May	Net Sales	$ 101,755	$ 44,990	$ 30,192	$ 13,754	$ 3,493	$ 7,726	$ 1,600
	Gross Margin	13,517	6,749	2,868	1,513	245	1,854	288
	Percentage of Gross Margin	13.28	15.00	9.50	11.00	7.00	24.00	18.00
June	Net Sales	$ 98,727	$ 47,542	$ 26,220	$ 12,382	$ 4,209	$ 7,263	$ 1,111
	Gross Margin	13,436	7,607	2,360	433	210	2,615	211
	Percentage of Gross Margin	13.70	16.00	9.00	3.5	5.00	36.00	19.00
July	Net Sales	$ 124,765	$ 52,908	$ 45,153	$ 14,863	$ 4,826	$ 6,497	$ 518*
	Gross Margin	15,413	6,788	6,317	392	243	1,602	71
	Percentage of Gross Margin	12.35	12.83	13.99	2.64	5.03	24.66	13.73
August	Net Sales	$ 109,032	$ 48,052	$ 33,912	$ 14,532	$ 4,406	$ 7,642	$ 488
	Gross Margin	13,051	6,674	3,744	385	198	1,997	53
	Percentage of Gross Margin	11.97	13.89	11.04	2.65	4.50	26.13	10.81
September	Net Sales	$ 103,558	$ 47,933	$ 28,563	$ 13,564	$ 4,380	$ 8,675	$ 443
	Gross Margin	11,448	5,594	3,336	324	265	1,858	71
	Percentage of Gross Margin	11.05	11.67	11.68	2.39	6.06	21.42	16.07
October	Net Sales	$ 109,915	$ 55,016	$ 26,252	$ 11,876	$ 3,404	$ 12,768	$ 599
	Gross Margin	12,451	6,085	2,588	277	193	3,220	88
	Percentage of Gross Margin	11.33	11.06	9.86	2.33	5.67	25.22	14.73
November	Net Sales	$ 97,741	$ 51,851	$ 25,208	$ 9,378	$ 2,249	$ 8,418	$ 637
	Gross Margin	12,158	4,511	4,860	162	138	2,285	202
	Percentage of Gross Margin	12.44	8.70	19.28	1.73	6.15	27.14	31.72
December	Net Sales	$ 106,874	$ 49,526	$ 33,250	$ 10,415	$ 2,615	$ 10,453	$ 615
	Gross Margin	11,600	5,572	3,824	240	144	1,672	148
	Percentage of Gross Margin	10.85	11.25	11.50	2.3	5.5	16.00	24.00
	Total Sales	$1,315,655	$600,853	$374,505	$176,401	$ 47,120	$104,548	$12,228
	Total Gross Margin	152,343	73,642	41,500	7,014	2,502	25,451	2,234
	Percentage of Gross Margin	11.58	12.26	11.08	3.98	5.31	24.34	18.27

*Nature of merchandise changed.

EXHIBIT 1 (*Continued*)

TOTAL AND DEPARTMENTAL NET SALES IN DOLLARS, GROSS MARGIN IN DOLLARS, AND PERCENTAGES OF GROSS MARGIN OBTAINED BY SNEED COMPANY, MONTHLY, JANUARY, 1921–DECEMBER, 1922, INCLUSIVE

1922		Total	A	B	C	D	E	F
January	Net Sales	$ 102,822	$ 43,155	$ 37,035	$ 8,881	$ 1,142	$ 11,976	$ 633
	Gross Margin	14,799	5,472	6,174	191	40	2,750	172
	Percentage of Gross Margin	14 39	12.68	16.67	2.15	3.50	22.96	27.17
February	Net Sales	$ 104,799	$ 42,204	$ 36,091	$ 11,228	$ 8,524*	$ 6,434	$ 318
	Gross Margin	15,919	4,668	8,045	241	1,569	1,304	92
	Percentage of Gross Margin	15.19	11.06	22.29	2.15	18.41	20.27	28.93
March	Net Sales	$ 109,382	$ 45,042	$ 28,645	$ 12,085	$ 11,914	$ 11,124	$ 572
	Gross Margin	14,820	4,734	5,365	263	1,784	2,485	189
	Percentage of Gross Margin	13.55	10.51	18.73	2.18	14.97	22.34	33.04
April	Net Sales	$ 99,167	$ 41,446	$ 26,634	$ 9,698	$ 8,456	$ 12,376	$ 557
	Gross Margin	14,844	5,400	5,082	295	1,762	2,148	157
	Percentage of Gross Margin	14.97	13.03	19.08	3.04	20.84	17.36	28.19
May	Net Sales	$ 110,974	$ 40,535	$ 39,567	$ 13,096	$ 8,075	$ 9,222	$ 479
	Gross Margin	15,791	5,136	6,770	356	1,560	1,878	91
	Percentage of Gross Margin	14.23	12.67	17.11	2.72	19.32	20.36	19.00
June	Net Sales	$ 122,747	$ 44,752	$ 35,844	$ 22,894	$ 10,052	$ 8,404	$ 801
	Gross Margin	12,479	5,129	3,788	723	1,366	1,218	165
	Percentage of Gross Margin	10.17	11.46	10.82	3.16	13.59	14.49	20.60
July	Net Sales	$ 95,887	$ 38,214	$ 21,110	$ 18,510	$ 8,705	$ 9,060	$ 288
	Gross Margin	12,623	4,685	3,789	491	1,788	1,800	70
	Percentage of Gross Margin	13.17	12.26	17.95	2.65	20.54	19.87	24.31
August	Net Sales	$ 99,287	$ 43,236	$ 17,899	$ 24,576	$ 6,544	$ 6,545	$ 487
	Gross Margin	12,126	5,301	3,215	651	1,475	1,365	119
	Percentage of Gross Margin	12.21	12.26	17.96	2.65	22.54	20.86	24.44
September	Net Sales	$ 104,740	$ 50,564	$ 20,618	$ 17,571	$ 6,823	$ 8,735	$ 429
	Gross Margin	14,111	6,604	3,711	466	1,402	1,823	105
	Percentage of Gross Margin	13.47	13.06	18.00	2.65	20.55	20.87	24.48
October	Net Sales	$ 108,082	$ 47,518	$ 24,275	$ 13,851	$ 12,092	$ 9,761	$ 585
	Gross Margin	15,046	5,826	4,360	436	2,243	2,037	144
	Percentage of Gross Margin	13.92	12.26	17.96	3.15	18.55	20.87	24.62
November	Net Sales	$ 120,300	$ 58,135	$ 21,190	$ 13,396	$ 13,537	$ 13,138	$ 904
	Gross Margin	16,725	7,122	3,806	355	2,511	2,741	190
	Percentage of Gross Margin	13.90	12.25	17.96	2.65	18.55	20.86	21.02
December	Net Sales	$ 187,490	$ 73,376	$ 76,002	$ 14,874	$ 11,322	$ 11,343	$ 573
	Gross Margin	27,628	8,996	13,650	394	2,101	2,367	120
	Percentage of Gross Margin	14.74	12.26	17.96	2.65	18.56	20.87	20.94
	Total Sales	$1,365,677	$568,177	$384,910	$180,660	$107,186	$118,118	$ 6,626
	Total Gross Margin	186,911	69,073	67,845	4,862	19,601	23,916	1,614
	Percentage of Gross Margin	13.69	12.15	17.63	2.69	18.29	20.25	24.36

*Nature of merchandise changed.

lated. There also was prepared an analysis by departments of the sales of each salesman. These records were available for the use of all the company's executives. A salesman's attention was not called, by executives, to the analysis which had been made of his sales unless his sales volume in any of the departments was below the average. The records of three salesmen who had been in the employ of the company for 15 years were used as a standard by which the relative performance of a salesman was determined. The executives of the company believed that these three men were competent salesmen; hence, the arithmetic average of percentages obtained from the analysis of their sales was used as the standard.

There was one distinct advantage which the executives of the company had expected to obtain from the departmentization of sales and the consequent determination of the gross margins. They had thought that this information would enable the company to place sales emphasis upon articles in those departments which yielded the highest percentages of gross margin. This system of records also provided the basis for the monthly calculation of the stock-turn of each department; and for the more detailed analysis of increases in inventories and purchases. The analyses of monthly sales for the years 1921 and 1922 are shown in Exhibit 1. The gross margin figures in that table were based on cost-book costs rather than on actual costs. Exhibit 2 is a recapitulation of departmental operating figures. Actual costs and not cost-book figures were used in that table.

The executives of the company did not obtain the advantages from the departmentizing of merchandise which they had anticipated. During the two years previous to January 1, 1923, the stock-turn of the departments had been determined about six times. The four buyers did not believe that the information which was furnished to them monthly was of particular value. They did not make use of it unless it was called expressly to their attention by the president of the company, and it was their belief that the expense which was being incurred to provide the information could well be saved by the discontinuance of the records.

The executives concluded that little gain could be obtained from attempting to increase the gross margin by selling more

high gross margin merchandise. Each retail grocer desired a certain amount of the low gross margin merchandise. If the Sneed Company desired to retain his business, it had to sell him this merchandise. The amount of high gross margin merchandise which could be sold him then was limited, it was said, to the difference between the total of his low gross margin purchases and the total credit which the company was willing to extend to him.

EXHIBIT 2

FIGURES FOR DEPARTMENTAL NET SALES, PURCHASES, INVENTORIES, GROSS MARGINS, AND RATES OF STOCK-TURN, SNEED COMPANY, 1921

	Total	A	B	C	D	E	F
Net Sales	$1,315,664	$600,855	$374,508	$176,400	$47,123	$104,549	$12,229
Cost of Goods Sold	1,123,375	520,246	296,815	175,789	43,060	77,640	9,825
Beginning Inventory	157,137	65,058	74,140	832	678	10,295	6,134
Purchases	1,239,487	557,772	373,142	175,803	45,647	81,217	5,906
Inventory at End	273,249	102,584	150,467	846	3,265	13,872	2,215
Average Inventory	215,196	83,821	112,304	839	1,972	12,084	4,175
Gross Margin	192,289	80,609	77,693	611	4,063	26,909	2,404
Percentage of Gross Margin	14.62	13.42	20.74	.35	8.62	25.74	19.66
Stock-Turn (times a year)	5.2	6.2	2.6	209.5	21.8	6.4	2.4

The executives concluded further that an energetic salesman would obtain, without the use of the sales analysis, any advantage which could be obtained by increased sales effort in high gross margin lines. The price book which each salesman carried gave not only the selling price but also the cost-book cost of the merchandise. Each salesman knew, therefore, the approximate gross margin which was being obtained on each sale. If the amount of gross margin credited to him at the end of any one month were below his average, he could ascertain the cause of the decrease by reference to his order blanks. It was the opinion of the executives, furthermore, that the company would gain no advantage from efforts expended on salesmen who did not have enough interest in their own income to analyze the sales which they were making and to ascertain the cause of any decreases.

Although the sales analysis given in Exhibit 2 showed that the percentage of gross margin had increased slightly, the executives attributed this largely to the improved conditions in the wholesale grocery trade.[3] It was pointed out further that, for example,

[3] The common percentage of gross margin for wholesale grocers with sales of

the sales in Department C, the department with the lowest gross margin, had not decreased throughout the two-year period. In fact, the sales during the last three months of 1922 were $42,121 as compared with $31,669 in the last three months of 1921, showing an increase of about 33%. Because of the lack of improvement resulting from the system, the disregard for the records shown by buyers, and the cost of obtaining the information, the company decided to discontinue the departmentization of sales and inventories after 1922. As the regular bookkeeper could departmentize purchases with little effort, and since they gave an indication of the volume of sales in each of the departments, the company continued to departmentize this information.

COMMENTARY: In view of its experience with the use of the data obtained by departmentizing the merchandise accounts, the company was warranted in discontinuing their compilation. The buyers made little use of the data and they did not serve as a guide for directing the efforts of the salesmen. Under such circumstances there was little reason for continuing to incur the expense of having the data compiled. Whether or not these departmental figures could have been utilized for guidance in control of mark-ups and prices, and perhaps for other administrative purposes, is a question on which this experience of the Sneed Company throws no light. The decision by this company, moreover, affords no precedent of significance to other companies which have a personnel adaptable to the utilization of such statistical guides.

This company relied entirely upon the watchfulness of the stock clerks in reporting the condition of stocks and upon the memories of the buyers, refreshed occasionally by reference to previous orders, for determining the quantities of merchandise to purchase. The company did not keep even such elementary records as were employed by the Herrington Company[4] and the Covelle Company.[5] It is difficult, indeed, for a business to be permanently successful when so much valuable information regarding past experience is recorded solely in the memories of employees.

The data in Exhibits 1 and 2 furnish material for an interesting set of computations on a topic quite remote from the major issue in this

about $1,500,000, as found by the Harvard Bureau of Business Research, in 1921, was 9.7%; that in 1922 was 11.7%. Bureau of Business Research, Harvard University, Bulletin No. 30, *Operating Expenses in the Wholesale Grocery Business in 1921,* p. 33; Bulletin No. 34, *Operating Expenses in the Wholesale Grocery Business in 1922,* p. 26.

[4] See page 224.

[5] See page 229.

case. The monthly figures for gross margin in Exhibit 1 were derived from the use of cost-book cost figures. Those cost-book cost figures conformed to the market cost of the merchandise at the time it was sold. The gross margin figures in Exhibit 2 were calculated by the use of actual cost figures. Hence, a comparison of the gross margins given in Exhibit 2 with the total gross margins derived from the use of book-cost figures will show approximately the amount of the total gross margin in 1921 which resulted from speculative market gains.

The figures in the first column of the following table have been taken from Exhibit 1, and the figures in the second column are from Exhibit 2. The figures in the third column are the differences between the figures in columns 1 and 2.

Gross Margin—1921

Dept.	Based on Cost-Book Cost	Based on Actual Cost	Speculative Gain	
			In Dollars	% Sales
A........	$ 73,642	$ 80,609	$ 6,967	1.16
B........	41,500	77,693	36,193	9.67
C........	7,014	611	6,403*	3.63*
D........	2,502	4,063	1,561	3.31
E........	25,451	26,909	1,458	1.39
F........	2,234	2,404	170	1.39
Total....	$152,343	$192,289	$39,946	3.04

*Loss.

This indicates that the speculative gain, which resulted from buying in anticipation of advances in market prices, amounted to 3.04% of the company's net sales in 1921. The bulk of this gain was realized on the merchandise in Department B—canned goods.

This comparison suggests the possibility that such data as these over a period of years would throw important light on the mooted question of the profits gained from speculative buying in the wholesale grocery business.

May, 1926 M. T. C.

Sebring Wholesale Drug Company[1]

WHOLESALER—PATENT MEDICINE

Purchasing—*Use of Stock and Order Records in Regulating Purchasing.* In its patent medicine department, the company, a wholesale drug firm, stocked approximately 7,000 items with widely varying rates of sale. Each day the stock clerk sent to the buyer's office a report of the quantities on hand of items which, in his opinion, should be reordered. This information was transferred to a large bound-book in which quantities ordered also were recorded by items. The buyer examined the entries in this book daily and placed orders on the basis of his judgment concerning the information contained there. The company decided to replace this book by a file of cards. The cards could be referred to more readily than could the book records. Moreover, labor and the possibilities of error were reduced by having the stock clerk make his reports directly on the cards.

(1923)

The Sebring Wholesale Drug Company's sales of patent medicines approximated $2,000,000 annually. This merchandise constituted 50% of the company's total sales. The manufacturers of patent medicines advertised extensively, and the public demand for their products was so strong that in numerous instances they allowed only small discounts to wholesalers. The average of such discounts was about 16⅔% of the wholesale list prices. Intensive competition from other wholesalers, retail druggists' buying associations, and retail druggists who purchased directly from the manufacturers had forced the Sebring Wholesale Drug Company to allow a discount of from 5% to 10% off its list prices to retailers. Consequently, the company had obtained a gross margin of only 11% in its patent medicine department, which was insufficient to show a satisfactory net profit. This small gross margin focused the attention of executives upon means of effecting economies in operations and of increasing the rate of stock-turn. The buyer for the patent medicine department decided that the attainment of these results might be facilitated by improvements in the stock and purchase records in that department.

In the company's accounts the records of inventories, pur-

[1] Fictitious name.

chases, and sales were kept according to merchandise departments, so that the amount of gross margin realized could be determined periodically for each department. All expenses also were distributed to accounts for the merchandise departments. From these expense and merchandise accounts a profit and loss statement was drawn up for each department at the end of each accounting period.

The company carried approximately 7,000 items in stock in the patent medicine department. Manufacturers sought to sell a large number of new medicines to wholesalers every year and when, by advertising, a manufacturer had stimulated a strong demand for a new product, it was difficult for the company to refuse to stock it. The result was that the number of items carried tended to increase from year to year. It was difficult to forecast accurately the demand for a new patent medicine; hence, the company occasionally purchased stocks of articles for which demand failed to materialize.

Sales of medicines were affected largely by the season and weather. Sales in January and February usually were larger than in any other two months. The company had to keep sufficient goods in stock to supply the demand at all times. Some fluid medicines could not be shipped in cold weather; consequently, a supply sufficient for the company's needs until spring had to be ordered before freezing weather arrived. The average inventory in the patent medicine department of the Sebring Wholesale Drug Company was approximately $160,000.

Two separate stock-rooms were used for patent medicines, the reserve stock-room, and the active stock-room. When a shipment of merchandise was received from a manufacturer, it usually was stored in the reserve stock-room. Some medicines that sold exceptionally well, however, were delivered directly to the active stock-room. When for any item the supply in the active stock-room became less than the desired minimum, the supply was replenished from the reserve stock-room. The merchandise was arranged in the reserve stock-room so that the stocks needed most frequently were in the most accessible locations. In the active stock-room, merchandise usually was arranged according to manufacturers.

There was a stock clerk in charge of each stock-room. The

clerk in charge of the reserve stock-room had been in the company's service for more than 20 years. The younger man in charge of the active stock-room was his understudy. The reserve stock-room clerk knew from experience about what the minimum stock of each item should be. He made a survey of the active stock-room every morning. When he found that the stock of any item was at a minimum, he filled out a printed slip which had columns for the name and description of the article and for information as to the quantity on hand in the active stock. He then examined his reserve stocks, and if sufficient reserve stocks were available, he replenished the active stocks. If they were not available, he gave the slip to the clerk of the active stock-room, after having noted on the slip the quantity on hand in the reserve stocks. The active stock-room clerk then totaled the quantities on hand and copied the description of the articles and the total on another slip, which he sent to the buyer. Some of the articles had to be reported every few days, others not oftener than once in two or three months.

The buyer had two secretaries, who kept purchase and stock records in a large bound-book. If the company purchased but one article from a manufacturer, a page in the book was headed by the name of that article, but if more than one article was purchased, the page was headed with the manufacturer's name. Purchases were made from more than 500 manufacturers, and, since products of many of them required more than one page, the book contained several thousand pages. There was no index to facilitate reference to any particular item. In some instances the same item of merchandise was carried in several sizes, and, in that event, the several sizes were entered on a page consecutively, as individual items.

Each page of the book was divided into 15 columns, one for the list price and wholesaler's discount, one for a description of the article, and 13 for quantities on hand and purchased. The 13 columns were double, one section being used for entries of the quantities on hand, as reported to the buyer by the clerk of the active stock-room, and the other for entries of quantities purchased. Each day, when the stock clerk's report slips were received, one of the buyer's secretaries transferred the information from those slips to the stock and purchase book. For each

item reported she entered the date across the top of a new double column for that item and then entered the quantity in stock, as shown by the slip, in the left section of the column; the right section was reserved for entries of quantities ordered. After these entries were made, the buyer examined the book and decided whether to order the articles reported. If, in his judgment, there would not be many immediate sales of an item reported, he might delay the order, in which case he entered a date as a memorandum for follow-up. Customarily, however, orders were mailed the day the articles were reported. The buyer kept a copy of each order, by which the quantity of merchandise received was checked. A secretary entered the quantity ordered in the stock and purchase book in the right-hand section of the column in which the quantity on hand had been entered.

In order to determine whether the amount of the orders sent out during the month to date was excessive, the buyer had the statistics department summarize the amounts of the orders from time to time during the month. The buyer filed these summary sheets, and thus was able to compare the amount of his purchases from month to month and year to year.[2]

The buyer thought it might be possible to obtain the needed information more promptly and with a saving of labor by substituting for the stock and purchase book a card file. He proposed that information should be entered directly on the cards,

[2] Another wholesale drug company, comparable in size to the Sebring Wholesale Drug Company, used a stock-control system in its patent medicine department similar to that used by the Sebring Wholesale Drug Company. Instead of leaving the report date to the discretion of the stock clerk, however, the buyer had drawn up a definite schedule of dates on which the stock clerk was to report on the various items. The buyer had planned the schedule on a basis of his experience with the rate of stock-turn for each manufacturer's products. When one article of any manufacturer reached the minimum, the stock clerk was required to report on all articles purchased from that manufacturer. Two comparatively small loose-leaf books were kept instead of one large bound one. Names of the manufacturers on whose products reports were to be made on Monday, Wednesday, and Friday were in one book, and those for Tuesday, Thursday, and Saturday in the other book. Instead of copying descriptions of the articles on slips each morning, the stock clerk took the book to the stock-room and copied the quantities on hand directly into the book. Another difference was that the buyer's secretary entered all items reported each day in a large bound-book with columns for the quantities ordered, the quantities in stock, and the prices. When a bill was received from a manufacturer, the quantity ordered was checked and the price and discount entered in the book directly from the bill. The buyer had his secretary copy the date, quantity ordered, price, and discount on small cards, which were kept in a permanent file. These served as a basis for the study of stock-turn and the elimination of inactive items.

instead of first being entered on report slips. At the beginning of 1923, standard 12-inch by 12-inch cards were purchased for this purpose. Each card had columns corresponding to a page in the stock and purchase book. The cards were filed in a fire-proof metal case approximately 2 feet in length and of the proper height to hold the cards upright. The cards were arranged alphabetically by names of manufacturers, or by the names of products in instances where only one product was purchased from a manufacturer. To save the labor of rewriting, the file was kept in the active stock-room. When a report on an item was necessary, the active stock clerk entered the date at the top of one of the double columns and the quantity on hand in the left-hand section. The cards for such items as needed to be reported were removed from the file and taken to the buyer each morning. Occasionally, when an order was received from a customer, and the buyer desired to know immediately the quantity in stock, it was necessary for him to inquire of the stock clerk, since the buyer kept no record that was immediately available. That difficulty was overcome by the installation of a direct telephone service between the sixth floor, where the buyer's office was located, and the third floor stock-room, where the file was kept.

The card file contained approximately 2,000 cards. A study of the dates on which orders had been placed and the quantities ordered enabled the buyer to estimate the rates of stock-turn for the various items. Since under the new system much work of copying information was eliminated, the services of but one of the buyer's secretaries were needed. When one side of a card was filled, the reverse side was used, after which the entries on the first side were erased, and the process was recommenced. The buyer thought there was no value in making comparisons for a longer period than 12 months, and records for this length of time ordinarily could be placed on one side of a card. After the system had been in use for about one year, the executives of the company were convinced that it was a distinct improvement, in that its use had materially reduced labor and the possibilities of error in keeping the records. Its use had been extended to one other department, and the company planned to install the card system in the other departments as soon as practicable.

Commentary: The company's experience with a card system of stock and purchase records indicates the advantages of that type of system in a business which handles a large number of items of varying degrees of activity. If there were offsetting disadvantages, they were not brought out in this case.

The chief weakness in the systems which the company used, both the bound-book system and the card system, was the absence of adequate statistical summaries of the data in the records. No regular means was provided, furthermore, for bringing to the buyer's attention stocks of inactive items.

Inasmuch as entries were made on the records only when stocks were depleted, the time intervals between entries were irregular. The summary tabulations prepared for the buyer by the statistical department appear to have been casual and irregular. A regular monthly, quarterly, semiannual, or even annual summary of the purchases of each item, together with data as to the quantities on hand at the beginning and end of each period, would have provided statistical records which would have greatly facilitated the control of stocks by the buyer. Inasmuch as one of the purposes of these records was to increase the rate of stock-turn, a tabulation of the periodical summaries should have been maintained over a period substantially longer than one year.

The records as they were kept were serviceable for guidance in day-to-day operations. Even though the buyer was experienced and highly capable, however, a statistical record for comparable periods of time would have served to give a broader and sounder perspective for the determination of merchandising policies. It is practically impossible, even for an experienced person, to judge trends of purchases and stock-turn from a series of entries at irregular time intervals. It is only when those data are summarized by regular periods that real statistical comparisons can be made. This company had made a marked advance in its practice over the methods used by the Herrington Company,[3] the Covelle Company,[4] and the Sneed Company,[5] but its system of stock control was not fully rounded out.

May, 1926 M. T. C.

[3] See page 224.

[4] See page 229.

[5] See page 235.

DRASCAU WHOLESALE DRUG COMPANY[1]

WHOLESALER—DRUGGISTS' SUPPLIES

PURCHASING—*Use of Stock and Order Standards in Regulating Purchasing.* The company, a wholesale drug firm, decided to establish for each of the 17,500 items which it sold standard minimum and maximum stock limits. When the stock on hand of an item reached or fell below the minimum limit, the buyer, who would be kept informed of the conditions of the stocks, was to order a quantity sufficient to make the quantity on hand plus the quantity on order equal to the maximum stock limit for the item.

(1925)

Before 1925 the Drascau Wholesale Drug Company had no adequate system of stock control. The chief stock clerk from time to time observed the quantities of merchandise on hand and notified the buyer when, in his opinion, reorders should be placed. Since the company carried stocks of about 17,500 items, of an average total value of $125,000, it was difficult for the chief stock clerk to keep an accurate check on the merchandise. Hence, it frequently happened that items of merchandise ordered by customers were out of stock. This situation not only inconvenienced customers, but was unprofitable to the company.

The Drascau Wholesale Drug Company was located in a city with a population of about 300,000. The company's annual sales amounted to approximately $775,000, 80% of which were made to customers located outside of the city in which the company was situated, and 20% of which were made in the city. The company owned a five-story brick warehouse. The assembling, shipping, and billing departments were on the first floor of this warehouse, and the stocks of merchandise occupied the remaining four floors. Ordinarily broken packages of any item were not separated from unbroken packages of the item. A spiral chute conveyed merchandise from the upper floors to the first floor. A pneumatic tube system was used to transport orders from the billing department to the warehouse departments.

The company employed five traveling salesmen, whom it paid commissions averaging 2% of their net sales. These salesmen

[1] Fictitious name.

usually called on customers located outside the city at least once a week and on city customers twice a week. The company also had two salesmen who remained at the office, telephoning to many of the city customers each morning, and, in addition, serving customers who came to the warehouse for merchandise. One buyer did most of the company's purchasing.

For each item that it carried in stock the company kept a card record, upon which were recorded quantities purchased, dates of purchases, costs, and the names of the vendors. The buyer used these records in determining the rapidity of sale of the merchandise.

Each day the chief stock clerk examined a specific portion of the stock in the warehouse and noted those items which, from his past experience, he believed it was necessary to reorder. The buyer, on the basis of the information given him by the chief stock clerk and the card records which were maintained, placed his orders.

This method of merchandise control was unsatisfactory to the executives of the Drascau Wholesale Drug Company. It was difficult for the chief stock clerk to keep an accurate check on all items. The executives concluded that if this method were continued, it would be necessary to employ an assistant chief stock clerk at a salary of about $1,600. The time at which the buyer was notified to repurchase depended upon the judgment of the chief stock clerk. Even with long experience, it was difficult for one man to judge accurately the time at which reorders should be placed for so many items. It had been the experience of the company that the chief stock clerk tended to permit the stock on hand of some items to become too low before informing the buyer.

When the company received an order for merchandise which it did not have in stock, or an order which was larger than the quantity in stock, it adopted one of three courses. One course was to purchase the merchandise from one of its competitors. The wholesale druggists in the city in which the Drascau Wholesale Drug Company was located had an agreement whereby they sold merchandise to each other at the prices at which they customarily sold to retailers. Hence, the Drascau Wholesale Drug Company made no profit on merchandise which it purchased

from its competitors. The second course was to deliver a portion of the merchandise which the customer had ordered and to promise that the remainder would be delivered as soon as it was received in stock. The third course was for the company to order the merchandise from its customary supplier and to notify the customer that the merchandise would be delivered as soon as it was received by the company. It had been the experience of the Drascau Wholesale Drug Company that, when it adopted either of the last two courses, the customer usually purchased from another source the merchandise which the company was unable to deliver promptly. The executives estimated that the company's total purchases from competitors or on back orders amounted to 5% of sales.

Under the method of stock control used by the company, the buyer had no guide to the sizes of orders to place. It had been the experience of the vice-president, who formerly had been buyer for the company, that much of the buyer's time was spent determining the quantities to order. In the opinion of the vice-president, the company needed a method of stock control which would lessen the time spent by the buyer upon individual purchases.

The company decided to make a study of each item of merchandise in order to determine the minimum and maximum quantities which it was most economical to carry in stock. The minimum quantity of any item which it was economical for the company to have in stock on a specific date was taken to be that quantity which would supply customers' demands until additional merchandise ordered on that date arrived. It was necessary, therefore, in deciding upon a minimum limit for an item, to take into consideration the rapidity of sale of the item and the time required for delivery. Rate of stock-turn and quantity discounts were factors considered in the determination of the maximum quantities of merchandise to carry. The company attempted, as a standard maximum, to limit the quantity on hand of any item of merchandise to one month's supply.

The first study which was made included only those items of merchandise which moved quickly, but the company intended to set maximum and minimum limits for each item eventually. The maximum and minimum quantities which were determined

for the items studied were entered on small cards and those cards were posted near the bins in which the merchandise to which they applied was stored. Each stock clerk who took merchandise from the bins to fill orders was instructed to notify the chief stock clerk whenever the quantity of merchandise remaining was equal to or below the minimum quantity recorded on the card for that item. At the same time, the stock clerk also was to notify the chief stock clerk of the maximum quantity recorded on the card. The chief stock clerk in turn was to report this information to the buyer. The buyer, when informed that the stock of any item of merchandise was equal to or below the minimum quantity, was to order a sufficient quantity of the merchandise to make the total of the merchandise on hand and ordered equal to the maximum quantity.

In June, 1925, the new method of control had not been in force long enough for the executives to determine its advantages accurately, but they estimated that under the new method the quantity of merchandise which would have to be back-ordered would be reduced to no more than 1% of sales. After this system had been in operation for two weeks, the chief stock clerk had reported that it was of material value to him and that he wished to extend the system to include all items of merchandise in stock. The executives of the company believed that after the system had been in operation longer it would become even more effective than it was at first. The buyer intended to continue to study the accuracy of the maximum and minimum figures; if he found, when making a purchase, that the last purchase had been made more than a month previously, he would consider whether or not the maximum quantity had been placed at too high a figure. The executives believed that the new system could not be used so effectively for those items for which there was a seasonal demand as for other items. The executives intended, however, to undertake to establish, for items with seasonal fluctuations in sales, maximum and minimum stock limits for each of the periods of varying demand.

Commentary: The company's problem was threefold—(1) the determination of the minimum stock or order point for each item of merchandise; (2) the determination of the standard quantity to purchase on each order for a particular item; (3) the institution of oper-

ating methods which would assure proper utilization of those standards.

In this case a reduction in the quantity of merchandise which it was necessary to back-order or to purchase from competitors was stressed as the object of using such standards. Inasmuch as that quantity amounted only to 5% of the company's sales, the gain to be expected from the use of the standards for that purpose was not large. In addition to preventing shortages of merchandise, however, it is probable that the use of such standards also would reduce the inventory of items which previously had been purchased in too large quantities.

In regard to the first problem, that of establishing a minimum stock or order point for each item, the company seems to have used the right approach, by estimating the quantity which ordinarily would be required for filling orders received from customers during the period that would elapse between the placing of a purchase order with a vendor and the date when the merchandise ordered would be received. The problem of determining the standard size of order to be placed for each item, with allowances for quantity discounts and seasonal variations in demand, also, it seems, was approached from the proper standpoint.

On the third problem—that of instituting operating methods which would assure effective utilization of these standards—the evidence as to the propriety of the methods adopted is not conclusive. Provision was made for having the standard quantities to purchase recorded on slips posted in the warehouse where the merchandise was kept. This made it necessary for the chief stock clerk to notify the buyer of the standard quantity to buy whenever a notice was sent to the buyer that the stock of any item had been reduced to the order point. So far as can be judged from the information in the case, less labor would have been required and there would have been less danger of error if the standard quantities to buy (calculated with reference to the so-called maximum stocks) had been recorded on the cards on which the purchase records were kept.

The success of this method of controlling stocks and purchases was certain to depend upon the care with which the stock clerks reported when stocks reached the order points. The plan had worked well for two weeks, but the novelty had not worn off within that period; a two years' test would have been more instructive. The operating plan potentially was weak because of its dependence on the performance of the stock clerks in noting the quantities that remained on hand after merchandise was removed from stock to fill orders. If the stock clerks became careless, in the rush of filling orders, shortages of merchandise were even more likely to occur than under the old plan whereby the chief stock clerk regularly inspected stocks on hand. An alternative

plan would have been to centralize the control by keeping a balance-of-stock record for each item, on which inventories, purchases, receipts, and shipments were continually recorded. The cost of keeping such a balance-of-stock record very likely would have been no greater than the expense of having the stock clerks take time to check the quantity that remained on hand after each order was filled.

A system of stock control, to be fully effective, must provide for accurate records of the movement of the stock, for the establishment of standards derived from the data on the records, and for dependable utilization of the records and standards. The Sebring Wholesale Drug Company's methods of stock control were weak in not providing for the derivation of standards from the records.[2] The Drascau Wholesale Drug Company's plan provided for the establishment of standards, but it did not guard adequately against the possibilities of a breakdown in the operation of the system.

May, 1926 M. T. C.

[2] See page 244.

Burnthol Company[1]

WHOLESALER—DRUGGISTS' SUPPLIES

Sales Planning—*Reduction in Delivery Expense by Increase in Size of Orders Received.* The company, a wholesale drug firm, analyzed its cost of delivering merchandise to those of its retail customers who were located in the suburbs of the city in which the company was situated. The analysis showed that for those customers the ratio of delivery expense to gross sales varied inversely with the size of the orders delivered. The company undertook to reduce its delivery expense, in some instances by asking the customers to increase their purchases, and in other instances by soliciting orders from customers less frequently.

(1923)

The traffic manager of the Burnthol Company, a wholesale drug firm, had complete supervision of all incoming and outgoing freight. He also supervised the delivery of merchandise to city, suburban, and country customers. Suburban customers were those located in the outlying and thinly populated sections of the city in which the company was situated, and country customers were those located outside of that city. In January, 1923, the traffic manager completed an analysis of the costs incurred in each of the preceding five months in the delivery of merchandise to suburban customers. This analysis showed wide variations in the cost of delivery to different customers. In one instance, the expense of delivery in one month equaled 28% of the gross sales made to a suburban retail druggist during that month. In other instances, the expense of delivery was less than ½ of 1% of gross sales. The executives of the company recognized the need of formulating a definite policy to coordinate the sales efforts expended on suburban customers with the expenses of delivering merchandise to them.

The Burnthol Company was located in a city with a population of about 800,000. The company made approximately ⅓ of its annual net sales of about $5,000,000 to its 450 city and suburban customers; sales to suburban customers alone represented 2% of total sales.

[1] Fictitious name.

The company made deliveries to country customers by freight or by automobile express; the charges were paid by the customers. In contrast to its f.o.b. warehouse policy for country customers, the company paid the cost of deliveries to city and suburban customers. The company delivered merchandise to city customers by means of a fleet of seven trucks ranging in size from a passenger-car chassis with a truck body to trucks with a capacity of two tons each. The expense incurred for delivering merchandise to city customers, which consisted chiefly of truckage charges, equaled approximately 2% of the net sales to such customers. The company used the services of local express companies to make deliveries to suburban customers. The express companies usually had a minimum charge of 35 cents a package, with a graduated scale upward, according to the size of the package. Because its suburban customers were so scattered and purchased so irregularly that the operation of regular delivery routes was practically impossible, the Burnthol Company had not increased the number of its automobile trucks sufficiently to make deliveries to those customers.

The company's salesmen solicited each country customer either once a week or once in two weeks. The salesmen mailed the orders which they obtained to the Burnthol Company at the close of each day. Country customers frequently wrote to the company, between the calls made by salesmen, to order items of merchandise for which immediate delivery was needed. The company customarily shipped all merchandise ordered by country customers on the day the orders were received.

City and suburban customers were visited by the company's salesmen at least once a week. In addition, practically all of them were called by telephone; some were called each morning and others once or twice a week. All shipments to city and suburban customers were made on the morning following the receipt of the orders.

The city and suburban retail druggists, who knew that they would receive frequent telephone calls from the Burnthol Company, placed frequent small orders rather than less frequent large orders. These telephone sales necessitated many small deliveries by the company. The frequency of deliveries to city customers did not increase materially the delivery cost, since

established routes were covered regularly each day. The expense of deliveries to suburban customers, however, was affected by the size of order and the frequency of delivery. As many of the suburban orders were for quantities of merchandise which made up packages that were smaller than the maximum which could be sent for 35 cents, the ratio of delivery expense to sales could be reduced if the size of the orders were increased, either by an increase in the volume of sales obtained from the customers or by a decrease in the frequency with which the orders were placed.

In conducting the study of the costs of delivery to suburban customers over a five months' period, the traffic manager recorded the number of deliveries made to each customer during each month, the cost of the deliveries as determined by the express company's charges, the average sale per delivery, the total sales during the month, including those made by telephone and those made by salesmen's visits, and the ratio of delivery cost to gross sales. He did not attempt to determine the gross margin obtained on the sales to each suburban customer, nor to ascertain the trend of sales to each customer. The information obtained from this study is shown in Exhibit 1.

These figures showed that the cost of delivering merchandise to suburban customers was a relatively high percentage of the gross sales to those customers. The expense of delivering merchandise to city customers had averaged only approximately 2% of *net* sales to those customers, whereas the cost of delivering merchandise to suburban customers had averaged 2.35% of *gross* sales to them. The amount of net sales to suburban customers was not computed, since returns were not tabulated for that class of customers. The total expense incurred by the company for outward freight, express, parcel-post, and outward truckage had equaled only approximately .75% of total net sales.[2] On the operation of the business as a whole the company had incurred a loss of more than 1% of net sales. The average gross margin obtained upon all sales was 20%. It was evident, therefore, that

[2] Subsequent studies made by the Harvard Bureau of Business Research showed that the average expenditure by wholesale druggists for outward freight, express, parcel-post, and outward truckage equaled 0.55% of net sales. See Bureau of Business Research, Harvard University, Bulletin No. 50, *Operating Expenses in the Wholesale Drug Business in 1924*, Table 31, opposite page 64.

Exhibit 1

Analysis of Cost of Deliveries to Each Suburban Customer of the Burnthol Company during the Five Months September, 1922, to January, 1923

Customer Number	Month	Number of Deliveries	Total Cost of Deliveries	Average Gross Sales per Delivery	Total Gross Sales	Percentage of Delivery Cost to Gross Sales
1 called daily by telephone	September, 1922	5	$1.90	$ 12.87	$ 64.35	2.95%
	October	1	.35	36.25	36.25	.97
	November	4	1.40	5.92	23.69	5.91
	December	1	.50	47.12	47.12	1.06
	January, 1923	1	.50	13.17	13.17	3.80
2 called daily	September, 1922	13	5.50	15.57	202.39	2.72
	October	10	3.65	14.75	147.52	2.47
	November	8	3.60	24.45	195.63	1.84
	December	7	3.60	18.61	130.29	2.76
	January, 1923	5	1.90	32.13	160.63	1.18
3 called daily	September, 1922	7	2.60	17.03	119.20	2.18
	October	10	3.90	19.24	192.43	2.03
	November	6	2.75	26.82	160.90	1.71
	December	3	1.05	23.84	71.54	1.47
	January, 1923	6	2.55	23.06	138.36	1.84
4 called irregular-ly	September, 1922	6	2.10	5.44	32.64	6.43
	October	11	3.85	8.30	91.30	4.22
	November	7	2.45	6.48	45.39	5.40
	December	5	1.75	8.14	40.71	4.30
	January, 1923	3	1.05	18.80	56.40	1.86
5 called daily	September, 1922	12	5.00	15.67	188.00	2.66
	October	9	3.45	25.67	231.04	1.49
	November	10	3.65	28.18	281.80	1.30
	December	8	4.45	26.75	214.02	2.08
	January, 1923	9	3.15	22.97	206.73	1.52
6 called daily	September, 1922	23	8.20	6.25	143.76	5.70
	October	19	7.45	11.36	215.84	3.45
	November	21	7.35	7.34	154.12	4.77
	December	19	6.65	8.66	164.52	4.04
	January, 1923	8	4.45	26.78	214.23	2.08
7 called Tuesday and Thursday	September, 1922	6	2.25	7.73	46.37	4.85
	October	4	1.40	21.92	87.67	1.60
	November	5	1.75	13.71	68.56	2.55
	December	2	.70	31.63	63.26	1.11
	January, 1923	4	1.40	4.76	19.04	7.35
8 called daily	September, 1922	2	1.00	97.43	194.85	5.13
	October	1	.50	105.50	105.50	.47
	November	2	.85	71.36	142.72	.60
	December	3	1.85	46.33	138.99	1.33
	January, 1923	1	.35	137.93	137.93	.25
9 called daily	September, 1922	2	.70	13.55	27.11	2.58
	October	5	1.75	5.94	29.69	5.89
	November	4	1.40	8.19	32.75	4.27
	December	2	.70	9.76	19.52	3.59
	January, 1923	2	.70	8.96	17.91	3.91
10 called irregular-ly	September, 1922	1	.35	16.37	16.37	2.14
	October	1	.35	6.60	6.60	5.30
	November	....	....	......	......	....
	December	1	.35	14.60	14.60	2.40
	January, 1923	....	....	......	......	....

Exhibit 1 (*Continued*)

Analysis of Cost of Deliveries to Each Suburban Customer of the Burnthol Company during the Five Months September, 1922, to January, 1923

Customer Number	Month	Number of Deliveries	Total Cost of Deliveries	Average Gross Sales per Delivery	Total Gross Sales	Percentage of Delivery Cost to Gross Sales
11 called irregularly	September, 1922	....	....	......	......	....
	October	....	....	......	......	....
	November	....	....	......	......	....
	December	....	....	......	......	....
	January, 1923	3	$1.45	$ 31.30	$ 93.91	1.54%
12 called daily	September, 1922	10	2.85	6.90	69.04	4.13
	October	15	3.90	6.97	104.54	3.73
	November	18	4.50	6.23	112.17	4.01
	December	8	2.00	6.45	51.66	3.87
	January, 1923	15	3.75	6.75	101.24	3.70
13 called daily	September, 1922	17	4.70	12.89	219.21	2.14
	October	15	4.75	19.37	290.57	1.63
	November	13	3.40	10.79	140.26	2.42
	December	11	3.00	13.43	147.69	2.03
	January, 1923	12	3.30	19.20	230.38	1.43
14 called daily	September, 1922	21	5.95	14.11	296.38	2.01
	October	19	7.15	20.74	394.11	1.81
	November	15	4.20	18.93	283.95	1.48
	December	21	5.55	8.96	188.23	2.95
	January, 1923	21	6.45	20.54	431.42	1.50
15 called daily	September, 1922	17	5.70	15.29	259.87	2.19
	October	13	3.40	10.59	137.70	2.47
	November	10	2.65	13.37	133.71	1.98
	December	6	1.50	13.30	79.82	1.88
	January, 1923	7	2.40	15.23	106.61	2.25
16 called irregularly	September, 1922	2	1.75	92.28	184.56	.95
	October	5	1.40	14.12	70.62	1.98
	November	3	.75	101.18	303.54	.25
	December	2	.65	28.48	56.95	1.14
	January, 1923	3	1.20	36.82	110.46	1.09
17 called irregularly	September, 1922	3	1.05	34.67	104.00	1.01
	October	2	.50	10.00	20.00	2.50
	November	....	....	......	......	....
	December	1	.55	45.50	45.50	1.21
	January, 1923	....	....	......	......	....
18 called daily	September, 1922	9	3.00	20.94	188.48	1.59
	October	12	3.75	12.21	146.54	2.56
	November	12	4.05	10.96	131.53	3.08
	December	11	3.65	11.42	125.64	2.91
	January, 1923	14	4.25	10.11	141.55	3.00
19 called daily	September, 1922	16	4.30	6.90	110.44	3.89
	October	15	4.25	6.61	99.01	4.29
	November	12	3.30	7.93	95.14	3.47
	December	12	3.40	9.58	114.95	2.96
	January, 1923	15	4.05	7.83	117.43	3.45
20 called irregularly	September, 1922	7	2.50	14.07	98.47	2.54
	October	....	....	......	......	....
	November	13	3.40	6.02	78.28	4.34
	December	5	1.25	18.98	94.88	1.32
	January, 1923	2	.50	17.73	35.45	1.41

Exhibit 1 (*Continued*)

Analysis of Cost of Deliveries to Each Suburban Customer of the Burnthol Company during the Five Months September, 1922, to January, 1923

Customer Number	Month	Number of Deliveries	Total Cost of Deliveries	Average Gross Sales per Delivery	Total Gross Sales	Percentage of Delivery Cost to Gross Sales
21 called daily	September, 1922	6	$1.65	$16.91	$101.47	1.63%
	October	9	2.40	8.77	79.00	3.04
	November	11	3.05	8.94	98.39	3.10
	December	17	4.35	6.61	112.39	3.87
	January, 1923	9	2.25	10.72	96.52	2.33
22 called daily	September, 1922	26	8.00	17.57	456.92	1.75
	October	25	7.15	18.88	472.06	1.51
	November	26	8.45	17.30	449.70	1.88
	December	24	9.60	22.54	541.04	1.77
	January, 1923	24	8.25	24.48	587.65	1.40
23 called 3 times a week	September, 1922	13	3.70	20.35	264.62	1.40
	October	13	3.55	17.55	228.21	1.56
	November	13	3.55	19.32	251.15	1.41
	December	12	3.30	20.23	242.82	1.36
	January, 1923	15	4.50	24.29	364.42	1.23
24 called daily	September, 1922	13	5.60	37.16	483.07	1.16
	October	15	4.80	27.27	409.04	1.17
	November	12	3.60	32.10	385.20	.93
	December	15	6.30	29.31	439.58	1.43
	January, 1923	14	5.00	42.16	590.25	.85
25 called irregularly	September, 1922	3	.90	17.84	53.53	1.68
	October	3	.75	20.15	60.46	1.24
	November	4	1.30	5.07	20.26	6.42
	December	3	.75	5.41	16.22	4.62
	January, 1923	8	2.40	1.66	13.31	18.03
26 called irregularly	September, 1922	4	1.00	19.27	77.07	1.30
	October	4	1.00	14.36	57.45	1.74
	November	4	1.00	25.02	100.07	1.00
	December	3	.75	20.24	60.72	1.24
	January, 1923	8	2.00	12.63	101.07	1.98
27 called daily	September, 1922	2	.50	4.90	9.80	5.10
	October	4	1.00	6.25	25.00	4.00
	November	4	1.00	6.75	27.00	3.70
	December	....	....	......	6.00	....
	January, 1923	3	.75	7.33	22.00	3.41
28 called daily	September, 1922	22	6.70	10.65	234.27	2.86
	October	25	6.40	8.01	200.31	3.20
	November	22	6.25	9.10	200.09	3.12
	December	20	5.90	9.15	183.07	3.22
	January, 1923	23	6.65	12.72	292.56	2.27
29 called daily	September, 1922	1	1.65	......	......	....
	October	24	8.40	28.77	690.67	1.22
	November	26	7.70	12.52	325.48	2.37
	December	23	6.35	15.43	354.83	1.79
	January, 1923	24	7.65	15.57	373.63	2.05
30 called irregularly	September, 1922	....	....	......	......	....
	October	....	....	......	......	....
	November	2	2.25	39.00	78.00	2.88
	December	....	....	......	......	....
	January, 1923	4	1.00	18.75	75.00	1.33

Exhibit 1 (*Continued*)

Analysis of Cost of Deliveries to Each Suburban Customer of the Burnthol Company during the Five Months September, 1922, to January, 1923

Customer Number	Month	Number of Deliveries	Total Cost of Deliveries	Average Gross Sales per Delivery	Total Gross Sales	Percentage of Delivery Cost to Gross Sales
31 called daily	September, 1922	10	$2.80	$11.14	$111.36	2.51%
	October	8	2.15	11.34	90.71	2.37
	November	9	2.50	8.75	78.74	3.18
	December	8	2.00	6.77	54.12	3.70
	January, 1923	6	1.65	17.96	107.74	1.53
32 called daily	September, 1922	7	1.75	9.74	68.20	2.57
	October	9	2.55	6.16	55.40	4.60
	November	6	1.50	11.03	66.19	2.27
	December	9	2.40	10.68	96.18	2.50
	January, 1923	7	1.75	9.86	69.04	2.53
33 called daily	September, 1922	10	2.50	7.08	70.83	3.53
	October	10	2.50	9.17	91.72	2.73
	November	13	3.40	5.96	77.54	4.38
	December	11	2.75	6.00	65.97	4.17
	January, 1923	11	2.75	10.35	113.88	2.41
34 called daily	September, 1922	26	7.10	13.26	344.71	2.06
	October	26	7.90	9.85	256.01	3.09
	November	25	7.00	16.56	414.11	1.69
	December	24	7.95	13.70	328.98	2.42
	January, 1923	26	7.85	19.48	506.41	1.55
35 called daily	September, 1922	25	6.85	7.35	183.70	3.73
	October	21	5.40	9.28	194.95	2.77
	November	20	5.15	7.55	151.11	3.41
	December	20	5.05	6.44	128.86	3.92
	January, 1923	23	5.90	8.83	203.04	2.91
36 called daily	September, 1922	8	2.45	15.27	122.14	2.01
	October	7	2.05	7.88	55.17	3.72
	November	5	1.75	22.65	113.26	1.55
	December	7	1.75	12.33	86.32	2.03
	January, 1923	6	1.60	12.90	77.42	2.07
37 called daily	September, 1922	24	6.45	8.55	205.29	3.14
	October	23	6.35	6.02	138.41	4.59
	November	23	6.20	8.11	186.53	3.32
	December	20	5.75	8.43	168.66	3.41
	January, 1923	24	7.05	10.95	262.94	2.68
38 called daily	September, 1922	6	1.50	8.94	53.66	2.80
	October	14	3.65	3.76	52.75	6.92
	November	9	2.25	4.84	43.52	5.17
	December	7	1.90	6.88	48.18	3.94
	January, 1923	12	3.15	6.10	73.28	4.30
39 called daily	September, 1922	....	....	......	......	....
	October	....	....	......	......	....
	November	13	4.60	8.59	111.74	4.12
	December	15	3.90	16.14	242.10	1.61
	January, 1923	17	4.85	9.41	159.98	3.03
40 called daily	September, 1922	....	....	......	......	....
	October	....	....	......	......	....
	November	....	....	......	......	....
	December	3	1.95	64.27	192.81	1.01
	January, 1923	13	3.70	6.27	81.47	4.54

EXHIBIT I (*Continued*)

ANALYSIS OF COST OF DELIVERIES TO EACH SUBURBAN CUSTOMER OF THE BURNTHOL COMPANY DURING THE FIVE MONTHS SEPTEMBER, 1922, TO JANUARY, 1923

Customer Number	Month	Number of Deliveries	Total Cost of Deliveries	Average Gross Sales per Delivery	Total Gross Sales	Percentage of Delivery Cost to Gross Sales
41 called daily	September, 1922	....	....	......	......	....
	October	....	....	......	......	....
	November	....	....	......	......	...
	December	8	$ 2.00	$ 8.18	$ 65.41	3.06%
	January, 1923	2	.85	67.11	134.22	.63
42 called daily	September, 1922	22	9.75	16.90	371.89	2.62
	October	22	8.90	15.33	337.33	2.64
	November	20	8.05	14.47	289.45	2.78
	December	22	7.95	12.65	278.26	2.86
	January, 1923	23	17.00	29.63	681.65	2.49
43 called daily	September, 1922	18	7.95	15.92	286.56	2.77
	October	7	3.20	11.74	82.20	3.89
	November	8	2.80	1.21	9.71	28.84
	December	11	4.50	16.16	177.74	2.53
	January, 1923	13	4.55	13.28	172.65	2.64
44 called irregular-ly	September, 1922	6	2.10	30.38	182.30	1.15
	October	4	1.40	28.06	112.25	1.25
	November	3	1.05	35.64	106.93	.98
	December	4	1.70	37.76	151.02	1.13
	January, 1923	6	2.10	24.92	149.50	1.40
45 called irregular-ly	September, 1922	....	....	......	4.00	....
	October	2	.85	4.78	9.56	8.89
	November	3	1.20	18.86	56.58	2.12
	December	1	.60	15.89	15.89	3.78
	January, 1923	3	1.20	10.86	32.57	3.68
46 called daily	September, 1922	8	3.10	15.90	127.25	2.44
	October	11	4.00	9.09	99.99	4.00
	November	3	1.20	19.68	59.03	2.03
	December	9	3.15	8.17	73.50	4.29
	January, 1923	8	2.80	14.72	117.76	2.38
47 called daily	September, 1922	4	1.70	17.35	69.41	2.45
	October	4	1.55	14.17	56.68	2.73
	November	8	4.00	13.33	106.64	3.75
	December	3	1.05	11.10	33.29	3.15
	January, 1923	5	1.75	3.77	18.83	9.29
48 called daily	September, 1922	10	3.80	16.45	164.53	2.31
	October	10	4.10	16.26	162.56	2.52
	November	10	3.80	12.87	128.74	2.95
	December	11	4.00	8.51	93.62	4.27
	January, 1923	13	5.00	16.13	209.75	2.38
49 called daily	September, 1922	19	6.80	9.83	186.68	3.64
	October	19	7.50	8.97	170.48	4.40
	November	19	7.65	14.44	274.40	2.79
	December	18	6.60	8.21	147.79	4.47
	January, 1923	22	8.15	9.03	198.69	4.10
50 called daily	September, 1922	10	3.65	15.00	149.98	2.43
	October	8	2.80	6.24	49.92	5.61
	November	4	1.55	24.24	96.97	1.60
	December	4	1.55	5.96	23.84	6.50
	January, 1923	5	1.75	10.98	54.89	3.19

EXHIBIT 1 (*Continued*)

ANALYSIS OF COST OF DELIVERIES TO EACH SUBURBAN CUSTOMER OF THE BURNTHOL COMPANY DURING THE FIVE MONTHS SEPTEMBER, 1922, TO JANUARY, 1923

Customer Number	Month	Number of Deliveries	Total Cost of Deliveries	Average Gross Sales per Delivery	Total Gross Sales	Percentage of Delivery Cost to Gross Sales
51 called daily	September, 1922	17	$7.00	$ 17.79	$302.39	2.31%
	October	12	4.65	16.32	195.88	2.37
	November	13	4.85	11.21	145.76	3.33
	December	12	4.65	5.39	64.69	7.19
	January, 1923	11	3.85	17.43	191.75	2.01
52 called daily	September, 1922	8	3.25	18.63	149.07	2.18
	October	6	2.55	18.05	108.31	2.35
	November	4	1.70	9.05	36.18	4.70
	December	2	.70	19.85	39.69	1.76
	January, 1923	10	3.95	6.12	61.16	6.46
53 called daily	September, 1922	7	2.45	5.70	39.92	6.14
	October	5	1.90	18.14	90.70	2.09
	November	4	1.40	3.93	15.71	8.91
	December	2	.70	8.30	16.60	4.22
	January, 1923	8	2.80	7.38	59.06	4.74
54 called daily	September, 1922	6	2.55	11.70	70.23	3.63
	October	8	2.95	12.08	96.65	3.05
	November	6	2.55	10.81	64.85	3.93
	December	4	1.55	18.17	72.69	2.13
	January, 1923	7	2.90	8.86	62.04	4.67
55 called irregular-ly	September, 192.	4	1.40	4.72	18.89	7.41
	October	5	1.75	7.92	39.60	4.42
	November	5	1.75	7.09	35.46	4.94
	December	1	.35	9.68	9.68	3.62
	January, 1923	1	.35	15.70	15.70	2.23
56 called irregular-ly	September, 192.	1	.35	149.91	149.91	.23
	October	....	....	....	....	....
	November	1	.35	5.72	5.72	6.12
	December	3	1.05	2.97	8.92	11.77
	January, 1923	....	....	3.41	......	....
57 called daily	September, 192.	1	.35	26.00	26.00	1.35
	October	2	1.00	16.00	32.00	3.13
	November	3	1.20	5.00	15.00	8.00
	December	1	.35	14.00	14.00	2.50
	January, 1923	1	.35	......	......	....
58 called daily	September, 192	10	4.25	12.78	127.79	3.33
	October	11	4.60	17.22	189.40	2.43
	November	11	4.00	13.54	148.94	2.69
	December	9	3.30	10.66	95.92	3.44
	January ,1923	18	6.60	7.23	130.07	5.07
59 called irregular-ly	September, 1922	6	2.40	9.00	54.00	4.44
	October	2	.85	17.50	35.00	2.43
	November	3	1.05	10.67	32.00	3.28
	December	3	1.05	5.33	16.00	6.56
	January, 1923	....	....	......	14.00	....
60 called irregular-ly	September, 1922	3	1.20	10.66	31.99	3.75
	October	3	1.05	6.05	18.16	5.78
	November	....	....	......	25.32	....
	December	3	1.05	15.20	45.61	2.30
	January, 1923	4	1.55	17.54	70.16	2.21

EXHIBIT I (*Continued*)

ANALYSIS OF COST OF DELIVERIES TO EACH SUBURBAN CUSTOMER OF THE BURNTHOL COMPANY DURING THE FIVE MONTHS SEPTEMBER, 1922, TO JANUARY, 1923

Customer Number	Month	Number of Deliveries	Total Cost of Deliveries	Average Gross Sales per Delivery	Total Gross Sales	Percentage of Delivery Cost to Gross Sales
61 called daily	September, 1922	3	$1.20	......	......	....
	October	4	1.40	$ 18.15	$ 72.61	1.93%
	November	3	3.20	16.33	49.00	6.53
	December	2	.70	22.50	45.01	1.56
	January, 1923	13	4.85	14.31	186.07	2.61
62 called daily	September, 1922	1	.50	106.81	106.81	.47
	October	7	2.60	20.86	146.02	1.78
	November	5	1.90	14.72	73.59	2.58
	December	5	1.55	11.33	56.65	2.74
	January, 1923	7	2.45	19.58	137.08	1.79

unless the gross margin received on sales to suburban customers exceeded 20%, the company was incurring a loss in the sale of merchandise to those customers, since the delivery expense for them was in excess of the average for all customers.

Analysis of the study showed, for example, that the cost of delivering merchandise to Customer 4 had equaled 5.40% of gross sales in one month and 6.43% in another. The cost of delivery to Customer 6 had averaged about 4%. The cost of delivery to Customer 25 had equaled 6.42% of gross sales in November, 1922, 4.62% in December, and 18.03% in January, 1923. In November, 1922, it had cost the company 28.84% of the gross sales made to Customer 43 to deliver the merchandise. In that month the company had made 8 deliveries to this customer and the value of the merchandise delivered had averaged $1.21 per delivery.

The traffic manager, the sales manager, and the vice-president of the Burnthol Company discussed the problem of coordinating the company's sales and delivery policies. It was evident that the small size of the average order placed by many suburban customers made it unprofitable to deliver the merchandise. The company could obtain a larger average order per customer either by obtaining a larger volume of sales or by decreasing the frequency with which the customers placed orders. It was recognized, however, that delivery costs alone could not be the deciding factor in the policy adopted by the company. As competitors

were making deliveries and sales efforts in the same manner as was the Burnthol Company, any radical change in the company's delivery policy might result in a loss of sales. The complete discontinuance of sales to suburban customers was not considered. Under the circumstances the executives decided, somewhat arbitrarily, to make no change in sales policy with respect to those customers, the cost of delivering merchandise to whom did not exceed approximately 2½% or 3% of gross sales.

It was decided that the company should adopt one of two courses with respect to those suburban customers the expense of delivery to whom exceeded 3% of gross sales. The course to be adopted was to be decided upon in conferences between the sales manager and the salesmen soliciting orders from suburban customers. In these conferences, the following points would be discussed: rate of growth in the sales volume of the customer; potential total amount of sales which the Burnthol Company could expect to make to the customer; and the general desirability of the account. The latter point included such factors as the type of merchandise which the customer purchased and the credit risk involved.

One course which might be pursued was to inform each customer on whose purchases the delivery cost was high of the expense which the company was incurring in making deliveries to him and to request him to increase his purchases. Purchases of retail druggists situated in newly developed localities with small populations could be expected to increase as the population increased and, consequently, the company's cost of delivering merchandise to them would decrease. For example, the officials of the company recalled that at one time the cost of delivering merchandise to Customer 28 had equaled 5% of gross sales, while in January, 1923, the cost was but 2.27% of gross sales.

If it were decided that the delivery costs to a customer could not be reduced by asking the customer to increase his purchases, the salesman would call the customer by telephone less frequently. If, in the opinion of the salesman, no improvement could be obtained from less frequent calls, all telephone calls to the customer might be discontinued.

The results of the company's plan of reducing delivery costs

to suburban customers were satisfactory to the traffic manager and to the sales manager. In several cases it was found that, when retail druggists were shown the delivery expense figures, they were willing to increase the total volume of their purchases from the Burnthol Company. Others were willing to accept fewer deliveries while purchasing the same volume of merchandise from the company. It was not found that a reduction in the number of telephone calls to customers reduced materially the monthly sales made to those customers. The company intended to repeat the analysis of delivery costs from time to time and to change its policy toward individual customers in accordance with the results disclosed by the study.

Commentary: The company's method of attack on its problem of reducing delivery expense was unusually sound. The analysis of the size of orders and delivery expense by individual customers enabled the company to locate the unprofitable customers, each of whom could then be dealt with according to the individual circumstances. The data show that for about one-third of the customers the delivery expenses were abnormally high, apparently because their average orders were small.

The facts provided by this analysis, supplemented by the salesmen's knowledge of the status of the customers, made it possible for the company to adopt measures for reducing its delivery expenses, in instances in which those expenses were excessive, without disturbing its relations with other customers. Customer 35, for example, was buying even more merchandise from the company, in the aggregate, than was Customer 16, but the average sales per delivery were substantially greater for the latter, with the result that the delivery expense was about 1% of the sales to Customer 16 and more than 3% of the sales to Customer 35. It was desirable to induce Customer 35 to modify his practice but not to disturb Customer 16.

The analysis of customers' purchases in this case also shows the dangers of too frequent solicitation of orders from customers.

The decision of the company to refrain from making a similar analysis of the purchases by city customers may well be questioned. It is stated (page 257) that: "The frequency of deliveries to city customers did not increase materially the delivery cost, since established routes were covered regularly." It is altogether probable that a detailed analysis would have shown conditions among the city customers similar to those which existed among the suburban customers. In that

event, the utilization of means of increasing the average size of orders probably would have made possible an economical rearrangement of delivery routes, and perhaps a reduction in the number of trucks employed. It also must not be forgotten that a prevalence of unnecessarily small orders increases other expenses besides delivery expenses.

May, 1926 M. T. C.

Harbord-Hutchinson & Company[1]

WHOLESALER—DRUGS

Sales Planning—*Increase in Size of Orders by Quantity Discounts.* To meet competition from cooperative buying associations of retailers and to reduce its operating expenses by increasing the size of the orders received, the company, a wholesale drug firm, proposed to offer quantity discounts upon all cash purchases in original packages or in lots of more than three units.

Advertising—*Use of Consumer Advertising by Wholesaler.* The company, a wholesale drug firm which had no private brands, inserted a series of advertisements in newspapers in order to acquaint the public with the service rendered to retail druggists by wholesalers who, like itself, carried full lines and extended credit to customers. This advertising was expected to help the company in meeting competition from cooperative buying associations of retailers and from wholesalers specializing in the sale of rapidly moving items and selling for cash only. The company also inserted a series of advertisements featuring the services of retail druggists to the public.

(1922)

In 1921 the operating expenses of Harbord-Hutchinson & Company, a wholesale drug firm in St. Louis with annual sales of several million dollars, were appreciably in excess of the common figure of 16% of net sales reported by the committee on uniform accounting of the National Wholesale Druggists' Association. In addition to calling on customers in St. Louis, this firm's salesmen covered a region within a radius of 300 miles of that city. In St. Louis and in several other cities in its territory, Harbord-Hutchinson & Company had to meet severe price competition from wholesale drug firms which specialized on rapidly moving proprietary articles and from mutual and cooperative buying associations.

With the growing tendency toward hand-to-mouth buying in 1921 and 1922, especially on the part of city retailers, Harbord-Hutchinson & Company found that its handling expenses were increasing because of its large volume of sales in broken packages. For the purpose of encouraging purchases in original pack-

[1] Fictitious name.

ages, as well as to meet competition, the company had under consideration in 1922 a plan of granting a discount of 8% on all cash purchases in original packages. The plan also included a quantity discount of 5% on all cash purchases of more than one-fourth dozen when that quantity was less than the original package. Although the company had not made an elaborate study of the comparative costs of handling broken packages and original packages, it generally was conceded that the proposed new quantity discounts were larger than the probable savings which would be effected in operating expenses.

Harbord-Hutchinson & Company sold cigars, candy, phonographs, soda fountains and supplies, as well as a full line of drugs and sundries. The total number of items carried in stock was over 45,000. Retail druggists in the city of St. Louis who were regular customers of Harbord-Hutchinson & Company normally placed small but frequent orders. Sixty per cent of the orders from the city trade were for less than $7 each, and half of these were for less than $3. The city trade, therefore, was almost entirely a broken-package business, the average order consisting of from four to six items. Many articles were called for in lots of three or even one.

Of the company's 40 salesmen, 15 called on the city trade. Each city salesman had from 60 to 75 customers in his district, and he normally called on 10 or 12 of them each day. Salesmen's districts outside the city were larger and calls less frequent; in the more remote parts of the company's territory salesmen called only twice a month. Harbord-Hutchinson & Company had the accounts of over 5,000 retailers on its books, but not all those accounts were active. City salesmen were paid a commission of 3% on sales, out of which they paid their own traveling expenses. Salesmen in districts outside the city also were paid a commission of 3% on sales, but their traveling expenses were paid by the company. Country salesmen received full commissions on orders received by mail from their territories. All salesmen were given drawing accounts, and settlements were made monthly.

The competition felt most severely by the company was that of the so-called mutual drug companies. A typical organization

of this kind charged a membership fee to retailers of $25, required cash in advance on all purchases, made a 6% charge for operation, purchased directly from manufacturers wherever possible, and gave to its members the discounts which manufacturers offered wholesalers. These mutual organizations were more than cooperative buying associations, inasmuch as they endeavored to show a profit for their managements. In addition to this competition Harbord-Hutchinson & Company found genuine cooperative buying associations making headway among drug retailers in its territory. Also, in St. Louis several wholesale drug firms, specializing on proprietary medicines and other rapidly moving merchandise, sold for cash, transacted a large part of their business by telephone, and quoted from 8% to 10% off manufacturers' list prices to retailers. There also were several chains of retail drug stores in Harbord-Hutchinson & Company's territory. Although these chain store companies endeavored to make the bulk of their purchases directly from manufacturers, they sometimes bought from wholesalers and usually demanded 5% discount from the customary price to retailers. As an aid in meeting competition, Harbord-Hutchinson & Company made free deliveries in St. Louis by means of rented trucks; terms were f.o.b. carrier, however, for all orders to be delivered outside of the city.

At its offices and warehouse in St. Louis, Harbord-Hutchinson & Company employed 225 persons, most of whom were engaged in handling orders in the warehouse. The merchandise carried in stock by the company was physically departmentized in the warehouse in such a way as to facilitate the prompt filling of orders; the arrangement of departments was changed frequently, whenever demand for various classes of goods slackened or increased. When orders were received, copies were sent to the departments indicated, and the various articles specified on the orders were assembled on the shipping floor by means of chutes and conveyors. Each shipment was checked twice—once as the component parts left their respective departments, and again as a whole before it finally was packed. Harbord-Hutchinson & Company prided itself on the promptness with which it filled orders; normally by four o'clock each day all orders received up to one o'clock on that day had been shipped from the warehouse.

The buying organization of Harbord-Hutchinson & Company consisted of a buyer, and in some cases an assistant, for each of the following divisions: drugs and chemicals; proprietaries and pharmaceuticals; sundries; candy and cigars; phonographs; fountains and fixtures.

Each buyer kept purchase records on cards by articles and sources, showing both wholesale and retail prices. In addition to these records, stock records were kept in the warehouse showing for each stock number the amount purchased and the amount on hand at the regular monthly inventory. Four departments—namely, those for candy, phonographs, soda fountains and fixtures, and cigars, cigarettes, and tobacco—were completely departmentized; that is, separate records were kept not only of purchases, but also of sales, stocks, and expenses. Harbord-Hutchinson & Company had taken this step in order to be sure at all times that it was worth while to continue these departments. Because of the large number of items carried in stock and the high proportionate cost of checking many orders, no effort was made to keep separate departmental sales records for the remainder of the business.

Harbord-Hutchinson & Company customarily issued a new catalog once every three or four years. New price-lists, however, were issued weekly or monthly in several lines of merchandise.

Harbord-Hutchinson & Company's terms were 1% for cash in 10 days, net 30 days. On about 70% of its sales, cash discounts were taken. The company ordinarily secured cash discounts of 1% or 2% from manufacturers; in the case of proprietaries the cash discount sometimes was as high as 5%. The rate of stock-turn was from 5 to 7 times a year.

The firm did not engage in any manufacturing operations and had no private brands. For stationery, rubber goods, and hair nets, it had exclusive agency agreements with manufacturers. These arrangements were exclusive only in the city of St. Louis and the immediately surrounding territory; there was competition with other wholesalers handling these lines in the more remote districts.

In addition to trade-paper advertising and direct circularizing, Harbord-Hutchinson & Company during the years after the World War undertook a program of institutional advertising,

principally in St. Louis daily newspapers. The advertisements in this series were for the purpose of acquainting the public with the nature of the service rendered to retail druggists by the wholesaler. Although no reference was made to wholesalers who specialized on the sale of rapidly moving goods at lower prices for cash only, or to mutual and cooperative buying associations, it was hoped that indirectly this advertising would help Harbord-Hutchinson & Company to meet competition from those institutions. During 1921 the firm also undertook to advertise the retail druggist to the public, both in St. Louis papers and in local mediums in other towns. The advertisements in this series featured the service that the local druggist was prepared to render his customers in general and on special occasions, such as during epidemics. Harbord-Hutchinson & Company also made arrangements to assume the cost of printing for its retail customers when they wished to conduct special sales, and its representatives frequently were sent out to arrange window and counter displays. At inventory time retail druggists frequently requested assistance, and Harbord-Hutchinson & Company encouraged competent employees of its own to help retailers for a small fee.

Commentary: If the company were to have granted the proposed quantity discounts on cash purchases, with the result that the number of small orders was lessened, savings would have been effected in handling charges, in interest, delivery, and collection expense, and in losses from bad debts. But there were two major objections to the plan. The first was that customers might have been induced to buy in larger quantities than they required, thereby accumulating unnecessarily large inventories. The other objection was that the proposed discounts were greater than the estimated potential savings to the company.

If the company had put the plan into effect without changing its list prices, the result would have been a loss, since the discounts were expected to exceed the savings. If the list prices, from which the discounts were to be quoted, had been raised so as to avoid a loss on the discounts, the net prices would have remained the same and the company would have secured no advantage over those cooperative buying associations which operated on a 6% margin. The quantity discounts on cash purchases, therefore, did not promise a solution of the problem of meeting the competition of the cooperative buying associations.

Before deciding on any policy, the company needed to have a careful

analysis made of its sales methods and stock-control plans. Perhaps such an analysis would have revealed conditions, for example, similar to those which existed in the Burnthol Company's business.[2] The conditions which Harbord-Hutchinson & Company faced were typical of those in the wholesale drug trade in numerous localities. They were similar also to the conditions in the grocery, wholesale hardware, and wholesale dry-goods trades, for instance. One of the chief reasons for the precarious positions of numerous wholesale firms in these trades, at the time when this problem arose, was that those firms had not analyzed the facts regarding their businesses or recognized the import of some of the facts that they had compiled. Harbord-Hutchinson & Company did not have the facts at hand on which to proceed intelligently.

The company's experiment with advertising to consumers was abortive. The company had no brand to which to relate its advertising. If it had been successful in stimulating greater appreciation of the unit retail drug stores by consumers, that appreciation would have been bestowed as freely upon the stores which were members of cooperative buying associations as upon those stores which patronized wholesale druggists such as Harbord-Hutchinson & Company. The company's potential gain from such advertising was too slight to warrant the incurring of the expense.

May, 1926 M. T. C.

---

[2] See page 256.

Crosby Broom Company[1]

MANUFACTURER—BROOMS

Product Adaptation—*Appearance of Product as Governing Manufacture by Machinery.* The company, which manufactured hand-made straw brooms for household and industrial use, could have effected an appreciable saving in costs of quantity production by using a patented machine for one of the manufacturing operations. The president of the company was convinced, however, that consumers would object to the appearance of the machine-made brooms. Consequently, the company decided not to use the patented machine.

(1922)

In 1924 the Crosby Broom Company, of Chicago, made and sold approximately 25,000 dozen straw brooms to 1,000 retail grocery stores and to 300 wholesale grocery and wholesale paper companies. A majority of the company's customers were located within 300 miles of its factory. Six salesmen sold the brooms to customers in the territory outside of Chicago. The president of the company acted as salesman in the city. Approximately 75% of the company's brooms were manufactured for household use; the remainder were made for industrial users, such as factories, railroads, and mills. The prices of the brooms to wholesalers ranged from $4 to $10 a dozen, according to the quality of the material and the grade of workmanship. The manufacturer paid the freight on all shipments. Sixty-five per cent of the company's output was of low-grade brooms, 30% of medium-grade, and 5% of high-grade. The prices at which the brooms were sold to retailers by wholesalers and also by the company's salesmen were from 20% to 25% higher than the prices quoted to wholesalers.

Broom corn was purchased in rural districts by several employees of the company. It was shipped in bales to the factory, where the straw was cleaned and bleached, the seeds removed, and the straw graded. This work was done by women, most of whom were negresses. The broom straw then was bound with wire by hand to the wooden broom handle. First, a man bound a few strands of straw to the handle at one point. He then revolved

[1] Fictitious name.

the handle and bound more straw to it. This operation was repeated until a specified quantity of broom straw was bound to the handle. Eight men ordinarily were employed on this work; they were paid piece rates. The rates were so adjusted that the men received the same daily payment for binding 7 dozen high-grade brooms as for binding 11 dozen low-grade brooms. At the completion of the binding operation, the broom straw extended from the end of the handle in a fanlike manner. To make the broom more compact and sturdy, the straw was stitched together by machinery about 4 inches from the point where the straw was bound to the handle. The broom then was finished except for trimming and drying. The cost for making a dozen brooms of the grade which was sold to wholesalers for $5 per dozen was about $2 for material, 60 cents for sorting and bleaching, 66 cents for binding, and 20 cents for stitching, leaving $1.54 for indirect expenses, selling and general administrative expenses, and profit.

In 1921 the company had sought to reduce the cost of its brooms by installing a broom-binding machine which bound brooms of all grades at the rate of 100 dozen a day. The company paid the holders of the patent on that machine a royalty of 10 cents for each dozen brooms produced; no charge was incurred for the machine when it was idle. The wages of an operator for the machine were approximately $7.50 a day. Patented clamps were required in the machine binding process, and enough of those clamps for one dozen brooms cost 75 cents.

Specified quantities of broom straw were fed into the binding machine by an operator. Each bundle of straw was bound, under several tons of pressure, between two steel clamps approximately 5½ inches long, ⅝ of an inch wide, and ⅛ of an inch thick. The clamps were held in place by 4 ordinary nails, which were bent and clinched to form rivets. A semicircular flange was provided in the middle of each clamp so that when the broom was bound the 2 half-collars formed a socket into which the handle was inserted. The broom was stitched and finished in exactly the same manner as were the hand-bound brooms. The upper end of the broom straw was cut off about ½ inch above the clamps; the rough ends of the straw and the metal collar gave the broom an angular, unfinished appearance. The metal clamps

were painted with a heavy coat of green paint, and, although they did not look clumsy, they added about 10% to the weight of the broom.

In 1921 the company had been unsuccessful in an attempt to sell the machine-bound brooms to wholesale companies at the same prices as those charged for hand-bound brooms. The wholesalers had objected to the appearance of those brooms. The company, therefore, discontinued the manufacture of machine-bound brooms within the year, although the president of the company was confident that, because of their sturdy construction, the machine-bound brooms not only would give as good service as the brooms bound by hand but would last even longer.

The Crosby Broom Company encountered keen competition. In addition to competition from numerous small broom factories, which could operate with little capital, the company met competition from state penal and blind institutions which made brooms. The president of the Crosby Broom Company was of the opinion that the brooms made by state institutions were not manufactured so carefully as were those made by private enterprises. It had been the experience of the Crosby Broom Company that the brooms made by such institutions were offered for sale in large quantities at prices which that company could not meet.

The president of the company stated that the small factories which were located in districts near the fields where broom corn was grown had an advantage over his factory because their transportation costs were low and because they could obtain labor at approximately 50% of the wage rates which the company had to pay in Chicago.

Most of the company's brooms for household use had been sold on a price basis. Many wholesale grocery and wholesale paper companies apparently preferred a fair grade of brooms at a low price to a high grade of brooms at a higher price. The preference of retailers depended largely upon the demands of their customers. Nearly all brooms sold by the wholesale grocers were unbranded; it was difficult, therefore, to distinguish by appearance the products of one manufacturer from those of another or from brooms manufactured by the state institutions. The brooms manufactured by the Crosby Broom Company were unbranded.

In 1924 the holders of the patent on the broom-binding machine reduced their charges for the steel clamps required for brooms bound by that machine from 75 cents to 40 cents a dozen pairs. The Crosby Broom Company was in a strong financial position and could afford to manufacture a stock of at least 5,000 dozen brooms as an experiment.

The company, however, did not resume the operation of the broom-binding machine. Although he recognized that he had no adequate experience for guidance, the president was convinced that consumers would object to the appearance of the machine-bound brooms.

COMMENTARY: Had it been necessary for the company to give heed to factory costs alone, the use of the binding machine would have been economical, for after the reduction in the price of the clamps a saving of 8½ cents a dozen brooms could have been effected. The cost of binding by hand was 66 cents a dozen, for the $5 grade; for machine binding the cost was 57½ cents a dozen. This saving of 8½ cents was slightly over 1½% of the selling price of the $5 grade—a worth-while addition to net profit.

The obstacle to effecting this saving was the added weight of the machine-bound brooms and their unusual appearance. A saving of 8½ cents a dozen in production gave no opportunity for offering reduced prices to consumers, and, in the absence of a motive for purchasing machine-bound brooms in preference to hand-bound brooms, the consumers naturally would continue to buy the familiar type of article.

March, 1926 M. T. C.

Allernet Lace Company[1]

MANUFACTURER—LACE

Distribution Channels—*Direct Selling to Prevent Piracy of Design.* The company, a manufacturer of machine-made lace, was a leader in the development of lace patterns in the United States. Its designs were imitated extensively by rival manufacturers. The company, in order to prevent such pirating of its designs, contemplated selling directly to retailers and cutters-up instead of through a selling agent to wholesalers and cutters-up, as was its established practice. The company had learned that wholesalers passed on to competing manufacturers samples of its laces.

Distribution Channels—*Direct Selling to Establish Manufacturer's Brand.* The company, a manufacturer of machine-made lace, marketed its product through a selling agent to wholesalers and cutters-up. Because of opposition from the wholesalers, the company had been unable to sell its lace under its own brand. The company contemplated changing its method of distribution and selling directly to retailers and cutters-up. It was thought that this change might enable the company to establish its own brand with retailers and consumers.

Distribution Channels—*Selected Distribution to Protect Style Leadership—(Commentary).* The company, a manufacturer of machine-made lace, was a leader in the development of lace patterns in the United States. The company wished to prevent imitation of its designs by rival manufacturers. The commentator states that the company's real objective should have been, not to prevent imitation altogether, but to delay imitation, and that the company should have sought its market for its new patterns among retailers and garment manufacturers dealing in exclusive merchandise instead of attempting to distribute its product to all types of retailers and cutters-up.

(1922)

The Allernet Lace Company, established in 1905 with 5 lace machines, in 1922 had 30 machines. Its product, which originally had been staple lines, in 1922 was almost entirely high-grade novelty goods. It employed about 200 men and women, many of whom were highly skilled. In addition, much of the lace, which was woven or twisted in 6-yard widths, was distributed to home workers to be separated into narrower widths. The company did all its own dyeing and finishing.

---

[1] Fictitious name.

Since the Allernet Lace Company was one of the few lace manufacturing companies in the United States that employed expert designers and draftsmen, its leadership in developing lace patterns had been established. As a result, its patterns were imitated extensively by rival companies. This pirating of lace patterns had become so serious that in June, 1922, the company made a special study of conditions with a view to remedying the evil.

It was discovered that the company's own customers were the source of samples from which designs and styles were imitated. All the company's lace had been sold through a selling agency in New York which had shown samples twice each year, in June and December, to cutters-up and wholesalers. The wholesalers, in turn, had required samples of the patterns which they purchased to show to retailers. In many instances the wholesalers not only had permitted the patterns to be seen by other lace manufacturers, but also actually had given them samples. Wholesalers had followed this practice on the theory that by encouraging competition they could purchase lace at lower prices. The Allernet Lace Company had explained to them that since the value of a lace pattern was dependent largely on its exclusiveness, this policy often proved ruinous to their own lace business through the resultant glutting of the market. The practice of giving away patterns, however, had continued.

Designs were worked out by the company's designers after the particular kind of lace to be favored by fashion had been determined. Late in 1921, for instance, the Parisian dressmakers were featuring Spanish lace. Through its selling agent, the Allernet Lace Company received assurance that the spring lace styles in America, following as usual the foreign styles, would be Spanish, chiefly fiber silk and wool, or spun silk and wool, in black and various other colors. The company's designers immediately developed patterns suitable for that type of lace. Experience had shown that designs that had been used many years before for the same kind of lace could not be used again. From each of the designs developed, the drafting, which was the most important part of pattern creation, had to be done. This consisted of making a large drawing showing the position of each thread in a different-color ink for each movement of the shuttles in the

machines. From this complicated drawing the design was coded so that the jacquard cards, which regulated the pattern in the looms, could be punched. After the pattern once was drafted, it easily could be imitated. For instance, after months of study and skilful drafting, the company's designers had produced a lace almost identical in appearance with a hand-made filet lace. Because of the low price for which it could be sold, this lace had been much in demand. This weave could not be patented, because it was itself a copy of a hand weave; hence rival mills almost immediately had imitated it and flooded the market.

Under existing laws, lace patterns could be patented at an average cost of $65 each, but two to three months' time was required from the date of application till the patent was granted. If placed upon the market during the interval that the patent application was pending, there was a risk that the designs would be imitated or the style changed before the patent was granted. The patentee could bring suit and collect damages from the infringing companies retroactive to the time when application for the patent had been made. Such legal action, however, had been considered too expensive and of doubtful benefit.

The evil of pirating styles had not been confined to the lace industry alone. A Design Registration League had been formed several years previously by representatives of practically every industry into which the element of fashion design entered. The conference committee of the organization included representatives of 21 trades, such as the lace, silk, and ribbon manufacturing industries, and 25 industrial associations, such as the Silk Association of America. The object of the league was to secure the passage of a bill by Congress which would "give to the designer and manufacturer the same adequate protection as the copyright granted to authors and their publishers."

The suggested bill provided for the removal of the subject of design protection from the patent division to the copyright division, and proposed at a cost of $1 for a copyright to give economical and immediate protection in place of the expensive and long-delayed registration under the patent law. Although it was not expected that this would prevent all pirating of designs, it was expected to discourage the practice. Many objections to the bill had been raised on the ground that so low a fee would encour-

age manufacturers to ask for unwarranted protection which would lead to endless litigation. It also was pointed out that such legislation might work an injury to innocent infringers.

Concerning the bill, however, the chairman of the Patent Committee of the House of Representatives had said:

> Many foreign countries have enacted statutes giving to authors of designs copyright protection, easily and quickly obtained at small cost. The process of procuring protection under our patent laws is necessarily slow, tedious, and expensive—the procedure under this bill is short and simple, resembling the practice in copyright cases, rather than patent cases. The Commissioner of Patents expresses the opinion that the statute will be capable of easy and effective administration, and will be helpful to the industries and commerce of the country. Some members of the Committee were at first inclined to fear that the bill might lead to excessive litigation, but the fact that the copyright law has not produced such results went far to allay their fears. We believe that the provisions of the bill are sufficient to protect registrants against actual offenders and also to discourage suits for technical and unsubstantial invasions of one's rights and make it practically impossible to bring, or to threaten to bring, vexatious actions to intimidate or oppress rival enterprises.

Although it was actively supporting this bill, the Allernet Lace Company was dubious as to the bill's efficacy. The provisions for quick action in copyrighting patterns were highly desirable, provided the fact that the pattern was protected would be a more serious deterrent to imitation than the words "patent applied for" had been. Because of the legal difficulties in establishing the fact of infringement, especially if the patterns varied in slight details, the Allernet Lace Company was convinced that even if the bill were passed, other means of preventing piracy would be necessary.

Shortly before this question came before the Allernet Lace Company for decision, several large lace companies had adopted a policy of selling directly to retailers and cutters-up, but the Allernet Lace Company was unable to ascertain whether they had made this change for design protection or for some other reason. If the Allernet Lace Company were to adopt this plan, it would be forced to establish a New York office and display rooms with a highly paid personnel. A competent manager could not be hired for a salary of less than $20,000 or $25,000 per year, and it was stated that the company would have to employ salesmen

not only to meet the retail buyers who came to New York but also to visit retail stores in all sections of the United States. Other salesmen would be required to sell to cutters-up, who after all might defeat the purpose of the change by demanding samples which they could give away. There also was the practical difficulty of adjusting the selling organization to the changed conditions each season, which resulted from the fluctuating proportion of the company's sales to cutters-up and to wholesalers. Past records showed that sales to wholesalers had varied from 10% to 90% of the season's totals, the remainder going to cutters-up. The selling agency had been able to shift its salesmen between wholesalers and cutters-up as conditions demanded. Although the company probably would save the wholesaler's profit and the 8% commission paid to the agency, it was doubtful whether this saving would cover the additional expenses of selling directly to retailers. Since the wholesalers carried many novelty lines, their selling expenses were spread over many products, while for the Allernet Lace Company one line would have to bear all the selling expense.

Another factor of importance was that a substantial part of the company's product was being sold as of foreign manufacture. American consumers apparently did not have faith in the ability of domestic lace manufacturers to produce a first-class novelty line such as the Allernet Lace Company was featuring. In most cases the retailers, themselves, were ignorant of the sources of the laces which they sold, as shown by an incident which occurred in the New Jersey city in which the Allernet mill was located. The manager's wife noticed a piece of Spanish "all-over" lace in a local department store show-case, which she recognized as one made in the local mill. She was surprised when told by the salesperson that the lace was imported, since "they cannot make lace like that in this country." If the Allernet Lace Company were to attempt direct selling, it anticipated that it might encounter distrust on the part of retailers and that temporarily at least the style leadership which the line had enjoyed might be weakened when the retailers discovered that the laces were of domestic production. The company also expected that it would be necessary to maintain a representative in Europe in order to secure the style assistance previously received from the selling agency; the latest

European styles were followed in America almost without exception.

The selling prices of novelty lace in which the Allernet Lace Company specialized had been fixed largely on the basis of what the traffic would bear. First, the style of garment with which the particular lace pattern would be used was determined. Then the cost of the other materials and the making of such a garment was figured. The price of the lace per yard was based on an estimate of what further expense the cutters-up or dressmakers would bear for the garment. The domestic companies could not have pursued such a policy, even with the protection of the 60% *ad valorem* tariff on importations, had not the quick changes in style made it impossible for foreign manufacturers to give sufficiently prompt deliveries. In the highest quality laces, however, especially those requiring a great deal of hand work, which were not subject to radical style changes, the domestic industry could not compete with foreign manufacturers.

In addition to the possibility of pattern protection, however, there seemed to be other advantages to be gained by the company by selling directly to retailers. The company's efforts to sell under its own trade name previously had been successfully blocked by the wholesalers, but the change would give the firm an opportunity to establish its brand with the retailers and cutters-up and thus to capitalize on the novelty style leadership which its laces had built up under foreign-appearing brands. Despite the fact that selling expense, administration costs, and credit risks would be increased—the selling agency had guaranteed accounts—it seemed that there might be an opportunity to secure an increased profit by establishing a reputation for style leadership among consumers. As the reputation of a modiste was often the chief element in the price of his costumes, the company believed that if it could establish a high reputation for style and design with consumers, it could demand higher prices. The direct contact both with the style centers and with the retail market probably would assist in the successful interpretation of style trends.

Commentary: The question of whether the company should have continued to employ the services of the selling agent or have organized

its own sales force was not directly involved in the problem of preventing style piracy, for on that problem the interests of the agent and of the manufacturer were in accord. Provided the agent was willing to cooperate closely with the manufacturing company in its merchandising plans, no evidence is adduced in the case to prove that the company should have altered its relationships with its selling agent.

On the relative merits of protection of designs by patent and by copyright, I shall not venture to express an opinion here. Either method of legal protection should have aided in preventing the grossest type of piracies, in which the company's designs were reproduced without change by the pirates. As soon as an imitator, however, made modifications in reproducing a pattern, he had grounds, more or less plausible, for averring that he was not guilty of infringement. Reliance on legal protection, therefore, would be almost certain to result in constant litigation, which would be expensive and not fully satisfactory to the company. It was necessary, consequently, to use a different approach in seeking alleviation of the evils of design piracy.

Inasmuch as the company was engaged in the production of stylish merchandise, it was impossible, and probably undesirable, for it to prevent imitation altogether. Each new style follows a more or less regular course.[2] When a new style appears on the market, it sells, if it is successful, on the basis of its novelty and distinctiveness. As soon as the success of a new style or pattern is apparent, it is imitated immediately in cheaper materials, and that process continues until the style becomes so vulgar that no one desires to purchase it. In the meantime, while the process of imitation has been under way, new styles have begun to appear. The Allernet Lace Company had occasion to prepare new designs constantly because of the continual force of the process of imitation. The fact that its designs were imitated, furthermore, was one of the reasons why it held a position of leadership. To have prevented imitation of its designs altogether, therefore, would have strangled its business.

The above reasoning points to the conclusion that the company's real objective was not to prevent imitation but rather to delay imitation of a new design until a sufficiently long period had elapsed to enable the company to recoup its designing expenses, cover its other costs, and secure a fair profit on the pattern.

When a new style or pattern is introduced in merchandise of this class, its vogue is established first in stores reputed to sell distinctive merchandise. Imitations find their widest currency through stores of another type, whose customers are desirous of emulating patrons of the distinctive stores. From this it follows that the manufacturer who orig-

[2] See Copeland, Melvin T., *Principles of Merchandising*, pp. 163-167.

inates new designs should seek his market for those designs in the distinctive stores. Garment manufacturers fall into the same classes as the retailers: one class caters to distinctiveness, another to emulation.

These distinctive retailers and garment manufacturers had the same sort of a problem as that of the Allernet Lace Company. They, too, suffered from too rapid imitation, in cheaper materials, of the new styles which they were offering for sale. Hence, it should have been possible to enlist the cooperation of such merchants and cutters-up in foiling the efforts of design "pirates" to secure samples of new patterns prematurely. The Allernet Lace Company, therefore, should have sought its market for its new patterns among the distinctive retailers and garment manufacturers. To have carried out such a program it probably would have been necessary for the company or its selling agent to sell directly to the selected retailers and garment manufacturers. In that manner, the imitators probably could have been prevented from securing samples of the new patterns until they were offered for sale in the retail stores. Much of the company's suffering from the evils of design piracy was caused by the fact that the company was attempting to distribute its product to all types of retailers and cutters-up, whereas, for its new designs, it should have catered to a specialized market.

The question of preventing representation of the company's product as of foreign origin is not specifically raised in this case. That practice, however, was one that the company should not have condoned.

April, 1926 M. T. C.

Cascade Department Store[1]

DEPARTMENT STORE—WOMEN'S SUITS

MERCHANDISING—*Purchase of Seasonal Style Goods at Wrong Stage of Style Cycle.* Tweed suits which the department store purchased for the opening of the season proved to be popular and were sold at high mark-ups. The buyer, consequently, decided to purchase additional quantities of the suits. As the season progressed, the designs were copied by more and more manufacturers and produced in large quantities. Manufacturers' prices declined. The department store and its competitors reduced retail prices to correspond to replacement costs. The popularity of the style was short-lived and the store took heavy mark-downs on the stock which remained on hand at the end of the season.

RETURNS AND ALLOWANCES—*Treatment of Customer's Complaint Caused by Mark-down.* Tweed suits which the department store purchased for the opening of the season proved to be popular in style and were sold at high mark-ups. The style was reproduced speedily by other manufacturers, and prices declined. At the end of the season the stock which remained on hand was marked down to a nominal figure to be closed out. During the final sale, a customer who had purchased a tweed suit at the opening of the season complained that the disparity between the price she had paid and the mark-down price showed that she had been charged an exorbitant price. The store did not grant the customer a rebate.

PRICING—*Determination of Price for Seasonal Style Goods—(Commentary).* On tweed suits which the department store purchased for the opening of the season initial mark-ups of 44.1% and 48.5% of the selling prices were placed. The average operating expense of the department was 26% and the normal gross margin of the department was 30% of net sales. The high initial mark-ups were necessitated by uncertainty as to whether the style would prove to be popular and by the risk that heavy mark-downs subsequently would have to be taken.

(1922)

Well in advance of the spring season of 1922 the buyer for women's suits in the Cascade Department Store, an eastern metropolitan retail establishment selling high-grade merchandise, placed orders for 146 tweed suits. It was his judgment that tweed suits would be popular in the spring of 1922, both because of the general style movement toward sport clothing and also because tweeds, being of loose-weave construction, could be manu-

[1] Fictitious name.

factured to retail at lower prices than many fancy woolen and worsted fabrics.[2] Nevertheless, he did not wish to order tweed suits heavily before he had tested their popularity with the store's clientele, since the style trend had been away from suits during the previous two seasons.

The expense, direct and prorated, in the women's suit department in the Cascade Department Store was normally 26% of net sales, and the net profit normally was 4% of net sales. Eighty-one tweed suits, purchased at $25 each, were marked to retail at $48.50, and the other 65 suits in the first order, which were of somewhat less expensive material and cost $20 each, were marked to retail at $35.80. As soon as these suits were placed on sale, it was apparent that tweeds were to be popular. The buyer, therefore, placed orders for 372 suits. By this time other garment manufacturers had copied the designs of the pioneers in the tweed suit field, and competition had brought the price to department stores down to $17.50 for suits that previously had cost $20. The shopping bureau of the Cascade Department Store reported that competing department stores were selling at $30 tweed suits which were equal in value to those sold by the Cascade Department Store at $35.80. Therefore, as soon as the order was placed for 372 suits at $17.50 each, the retail prices on all tweed suits in the department were reduced to $25.

As the season progressed, sales of tweed suits continued to be large, and more and more manufacturers engaged in the production of this popular line. Replacement value fell to $15.50, at which figure the suit buyer of the Cascade Department Store, after consulting the merchandise manager, ordered 156 suits. At that time it was becoming difficult to secure deliveries on the dates promised, and several other department stores, which had not bought tweeds early in the season, were reported to be ordering heavily. By the time these suits were received, competitors were selling similar merchandise at from $21 to $23; consequently, the Cascade Department Store reduced the price to $19.75. Toward the end of the season it was evident that the popularity of tweeds was to be short-lived. In the Cascade Department Store 76 suits had been sold at $48.50, 64 at $35.80, 295 at $25, and 138 at $19.75. There were left in stock 101

[2] For a description of the setting and adoption of styles and their influence on manufacture, see Cherington, Paul T., *The Wool Industry,* chaps. xi and xii.

suits. Retail prices on these were reduced to $15 for a widely advertised clearance sale, and at this price 33 suits were sold. Three days later the price was reduced to $10, at which figure 28 suits were sold. There were still 40 suits left in stock which apparently would not move at a retail price of $10 each; consequently, rather than to carry any tweed suits over to the next season, the store reduced the price to $5, and at this figure all the remaining suits were sold.

During the closing-out sale of tweed suits at $5 each, a regular customer of the Cascade Department Store, who had purchased a tweed suit early in the season at $48.50, visited the suit department and protested in strong terms to the assistant buyer that, if the store could afford to sell tweed suits at $5 each, she had been greatly overcharged when she paid $48.50. The assistant buyer pointed out that nearly all the suits being sold for $5 were of poorer quality than the one that she had bought early in the season, and that the price for this final sale had been specifically advertised as "less than one-third original cost." The customer then raised the objection that it was unfair for the store to lower prices on these suits to a point where so many people of the lower social classes were wearing them that she no longer liked to wear hers. Eventually she went away dissatisfied.

COMMENTARY: This case involves three questions: the propriety of the original mark-ups; the wisdom of purchasing the last lot of 156 suits; and the treatment of the dissatisfied customer.

The mark-ups on the initial lot of tweed suits amounted to 44.1% of the selling price for those priced at $35.80 and to 48.5% for those priced at $48.50. Inasmuch as the average operating expense in the department was 26% and the normal gross margin 30% of the sales, the initial mark-ups on tweed suits substantially exceeded the average gross margin. The average gross margin, however, was the result not only of mark-ups but also of mark-downs and inventory losses resulting from style depreciation and other causes. To attain that average gross margin for a season, it was essential that the initial mark-ups should be materially greater than the average margin realized.

In this instance the tweed suits were purchased for sale on a style basis rather than on a price basis. Customers went to the store for the purchase of style goods. In catering to the demands of consumers who wished to purchase stylish merchandise, the store assumed the risk of heavy losses on styles that proved not to be popular; it also had

to recognize that on a portion of its purchases of a popular style mark-downs were likely to be unavoidable before the end of the season. It was necessary to provide for those contingencies in the original mark-ups. Those mark-ups, therefore, were proper.

Subsequent experience showed that the profits of the store would have been greater if the last lot of 156 suits had not been purchased. In merchandising style goods, however, the vagaries of consumers' tastes never can be foreseen entirely and it is impossible to avoid mistakes altogether. In this particular instance, therefore, the pertinent question is whether due heed was given to the symptoms of style decadence that had manifested themselves in the tweed suit market prior to the date on which that last order was placed.

The imminency of a style change was indicated prior to that date by the rapid increase in the popularity of the style and its reproduction in cheaper fabrics. Except for tweed suits, it was not a good suit season. The rate of reproduction of the style and the continual drop in prices indicated that the style rapidly was breeding its own destruction; its increasing popularity on lower price scales and with cheaper materials meant that it soon would not be in demand among the regular clientele of the Cascade Department Store. The type of customers who had purchased the style when it was first offered at the prices then placed on the suits would not be disposed to buy tweed suits when it had become apparent that cheaper and cheaper imitations were being offered for sale. The decline in the selling price from $48.50 to $25 was great enough to have indicated to the department buyer and merchandise manager that the style was passing into a stage in the style cycle that was inconsistent with this store's merchandising policies.

If these symptoms had been carefully diagnosed, it is probable that the executives of the store would have chosen to risk the loss of a few profitable sales rather than to risk heavy mark-downs. In order to retain the patronage of its clientele, furthermore, the store should have endeavored to avoid offending its earlier customers for tweed suits, who might resent radical reductions in its prices of such garments within a season. The purchase of the last lot of suits was not wise.

The store was right in not granting a rebate to the customer who complained that she had been overcharged. Although it was desirable to retain her good-will, the mark-up policy of the store, as has been stated above, was justified by the circumstances. The store could not consistently have made an exception in the case of one customer, and a general policy of making rebates under such conditions would have been ruinous.

November, 1925 M. T. C.

Bernard Specialty Shop[1]

SPECIALTY STORE—SILK PIECE GOODS

Merchandising—*Judging Probable Demand for Seasonal Style Goods on Basis of Advertising by Manufacturers and Wholesalers.* The buyer for the silk department of the company's specialty shop was offered a line of high-grade silk taffetas at reasonable prices. Taffetas were being advertised extensively in trade journals and textile publications. The buyer was convinced, however, that manufacturers and wholesalers had been misled into overstocking and were trying to dispose of their stocks through advertising. The assistant buyer and the head salesman of the department reported a demand from customers and advised that an order be placed. The merchandise manager suggested that enough be purchased to provide an adequate assortment but not enough to involve a heavy loss if the demand was slight.

(1921)

In November, 1921, much advertising space in trade journals and textile publications was devoted to advertisements of silk taffetas. The advertisements expressed the idea that this material would be popular during the coming spring season. During one week in November salespeople in the silk department of the Bernard Specialty Shop reported six requests by customers for silk taffetas which were not in stock. The buyer for the department purposely had allowed his stock of this material to become depleted, because there had been a marked decline in demand during August, September, and October.

A salesman from the Marion Silk Company,[1] one of the largest wholesalers of silk dress goods in the East, called on the silk buyer of the Bernard Specialty Shop and showed him a line of high-grade silk taffetas at reasonable prices. The salesman assured the buyer that the demand for this material would be strong during the next three months and referred to the extensive advertising which was being done of silk taffetas. It seemed apparent to the buyer that manufacturers and wholesalers were well stocked in this material and were pushing it.

The buyer was not convinced that silk taffetas were going to be popular in the coming season. He followed his usual practice of securing the opinion of the assistant buyer and of the head

[1] Fictitious name.

salesman of the silk department before placing or refusing a large order of any kind. The buyer believed that the assistant buyer and the head salesman, since they were on the selling floor a large part of the time and consequently in direct contact with consumers, were in a position to judge the immediate demands of the department's customers. Both the assistant buyer and the head salesman advised the buyer to place an order for $2,000 worth of silk taffetas to be delivered in December, stating that it was evident from the calls which they had received that a demand existed. The assistant buyer suggested that extensive advertising of the material by the store would increase the demand or even create a demand if one did not already exist.

The buyer did not agree with his assistant in the contention that a demand for piece goods could be created merely through advertising. He was convinced that the supply of silk taffetas on the market was not a result of a carefully predicted demand but the outcome of a peculiar set of circumstances, which he explained as follows:

In the early part of October a buyer for the Strilet Suit and Dress Company,[2] of New York, manufacturers of cheap ready-made suits and dresses for women, began looking in the New York markets for materials to make up into cheap dresses that could be sold at prices which would allow a fair profit to retailers. Having decided that taffeta was the most desirable material for this purpose, the buyer of the Strilet Suit and Dress Company placed an order with a large broad silk mill for 100,000 yards of silk taffetas in various colors. News of this large order soon reached small manufacturers of silk dress goods and they, accepting it as evidence of a style trend, began to increase their production of taffetas. Other manufacturers of women's dresses learned of this apparent demand and also placed orders for taffetas. Many manufacturers and wholesalers, deceived by these seeming evidences of the fabric's coming popularity, overstocked on taffetas; the market soon had a large supply with very limited demand, and the result was extensive advertising in an endeavor to dispose of the merchandise.

The buyer stated that he was convinced that taffetas would not be particularly in demand during the coming season. The fash-

[2] Fictitious name.

ion publications, both from domestic markets and abroad, indicated that women's dresses were to be made with straight lines, for which taffetas were unsuitable. The bouffant styles which had been in vogue the season before were no longer being shown. The buyer pointed out that the head salesman and assistant buyer were more capable of predicting immediate demands than he was, because of their contacts with customers, but were in a less advantageous position for predicting future demands, since they were not so familiar with general conditions affecting style trends as he was.

The merchandise manager suggested a compromise, stating that he saw no objection to placing an order for taffetas amounting to not more than $1,000. The purchase of that amount, he stated, would assure the department of an adequate assortment to offer customers, but would not result in a particularly heavy loss if the demand for taffetas proved to be slight.

Commentary: The inquiries for silk taffetas in this store in November, 1921, were characteristic of a waning style rather than of an incoming style. The new styles of garments which were being shown were not adaptable to the use of taffetas. A strong demand for taffetas, therefore, was not to be expected. The fact that taffetas had been popular in the preceding year, with a subsequent waning of their popularity, was a strong reason for not expecting a substantial demand from consumers to develop again in the winter of 1921. A style which has been popular seldom is revived after such a short interval. The circumstances pointed out by the buyer afforded adequate explanation of the reasons for the advertising by silk manufacturers and wholesalers who had misjudged the style trend and accumulated stocks of taffetas.

The decision of the merchandise manager, therefore, to approve the purchase of only a small quantity of taffetas was sound. That quantity would be adequate to take care of the occasional requests which were a remnant of the demand in the preceding period of popularity of such fabrics. If occasional sales were lost, the disadvantage would be less than the loss which would be incurred by acquiring an excessive stock of merchandise in an obsolescent style. Such occasional losses of sales are inevitable in a store which adjusts its stocks foresightedly to seasonal style changes.

July, 1926 M. T. C.

Samoset Company[1]

MANUFACTURER—READY-TO-WEAR GARMENTS

Merchandising—*Standardization of Styles for Women's Ready-to-Wear Garments.* The company, a manufacturer of women's ready-to-wear garments, decided to concentrate on semi-standardized styles in order to lessen seasonal fluctuations in production and to reduce losses from style depreciation. The garments were trade-marked and advertised nationally.

Distribution Channels—*Use of Exclusive Agencies for Women's Ready-to-Wear Garments.* Although manufacturers and wholesalers of women's ready-to-wear garments ordinarily sought dense distribution, the company, which had developed semi-standardized styles in women's coats and suits, which it trade-marked and advertised nationally, granted an exclusive agency for its merchandise to one retailer in each locality.

(1922)

In order to stabilize its business and place it on a footing less susceptible to the effects of seasonal style changes in women's garments, the Samoset Company, although conforming to style tendencies as regards length, fulness of skirts, and other general features, had developed semi-standard styles in women's coats and suits. These garments were distinctly conservative and did not follow any fads or short-lived styles.

Irregularity of production had been one of the serious difficulties faced by most manufacturers of women's garments. With a factory idle four months in the year and working overtime during other periods, production was costly, and labor difficulties were perplexing. The seasonal peak in production was due directly to the fact that there were two buying seasons for women's garments—spring and fall. The peak was accentuated, however, because style changes were so frequent that manufacturers often were unwilling to make up garments in advance of receiving orders. In recent years, prior to 1922, retailers had tended to postpone as long as possible the date of ordering style merchandise in order to be sure of obtaining garments of the latest style.

In adopting its policy, the Samoset Company acted on the assumption that there was a demand among women for conserva-

[1] Fictitious name.

tively modeled garments, tailored in good taste, that could be worn more than one season. In addition to permitting production to be spread over a longer period of the year, the Samoset Company's policy facilitated the trade-marking and national advertising of its product, which was sold in department stores and women's ready-to-wear stores in many localities in the United States. Through large expenditures for advertising in newspapers and in periodicals, the Samoset Company had made both its policy and its product well known.[2]

Ordinarily, manufacturers and wholesalers, seeking the densest distribution possible, sold women's ready-to-wear garments, as well as piece goods, to department stores, metropolitan specialty stores, and other retail outlets for ready-to-wear goods and dry-goods without restrictions. The Samoset Company, however, granted an exclusive agency for its garments to one department store or other ready-to-wear retailer in each locality. The contract provided that the retailer was to have the privilege of selling at retail in his store all products of the Samoset Company, and that this privilege was not to be granted to any other retailer within a specifically defined territory. He was given the privilege of designating his store as "The Samoset Store" and agreed

[2] The H. Black Company, of Cleveland, had a style policy similar to that pursued by the Samoset Company. A typical advertisement of the H. Black Company, which appeared in a Chicago newspaper, read as follows:

WHOSE FAULT IS IT—
IF YOUR COAT OR SUIT IS OUT OF
STYLE NEXT SEASON?

Is there any reason why a coat or suit purchased this season should be out of fashion next year?

Certainly not, if you select a style which is assured of lasting, rather than something extreme and one-season.

"But why," you ask, "should stores carry one-season styles which I must discard next year?"

The answer is a simple one. The merchant buys what he feels he will sell. If he is progressive, he would prefer not to carry the extreme or bizarre—then he does not have to "sacrifice" those he does not sell in order to close them out while the vogue is in.

But, many women still insist upon regarding seriously every fashion note that "they are wearing this" or suits must be "thus and so." This type of woman demands "novelties" and it is for her that the store handles them.

You are safeguarded in YOUR choice, though, by knowing who makes the coat or suit you purchase.

No Wooltex Tailor-made or Wooltex Knockabout is ever designed on transient, faddish lines. The styles are as lasting as the fabrics themselves. Fine serges, tricotines, tweeds, homespuns, and Wooltex Sportspuns plus exquisite tailoring go into each of these coats and suits.

The label—the sign guarantee of the Wooltex Tailors—is inside each collar.

to put forth his best efforts to maintain and increase the sale of Samoset products, to keep a sufficient supply of Samoset goods on hand at all times to meet the demand, and to give these goods preference in purchase, display, advertising, and sale.

COMMENTARY: Under the plan adopted by this company, the buying motive of consumers upon which dependence chiefly was to be placed was economy in purchase, a rational motive, while seasonal style merchandise is sold largely on such emotional buying motives as emulation and economical emulation.[3] The exclusive agency provision meant that the garments were to be merchandised as specialty goods, although a large proportion of the purchases of women's garments are effected by shopping.

That a market exists for such goods as the Samoset Company was to make, there can be little doubt. Because of the strength of the buying motives for seasonal style goods and the pervasiveness of the shopping habit, however, it was not to be expected that garments of standard styles would largely supersede seasonal style garments. A retail firm which had a well-established trade in seasonal style garments probably would have been reluctant to accept a Samoset agency. The acceptance of an agency, to be sure, would have lessened the risks of loss from style depreciation, and the advertising by the Samoset Company would have had some effect in stimulating patronage. Yet the acceptance of the agency carried with it, properly, an agreement to give preference to Samoset goods in purchase, display, advertising, and sale. If a retailer were to carry out the Samoset agency agreement in good faith, he could not at the same time effectively merchandise seasonal style garments. The chief sales appeal for Samoset goods was a direct attack on the motives for buying garments seasonal in style.

Although a few garment manufacturing companies may be able to operate successfully on such a plan as that of the Samoset Company, it is not likely that the bulk of the women's garment trade will be shifted out of the shopping class.

November, 1925 M. T. C.

[3] Copeland, Melvin T., *Principles of Merchandising*, pp. 164-167.

Hanover Cotton Mills[1]

MANUFACTURER—GINGHAM

Brand Development—*Use of Consumer Advertising by Manufacturer of Seasonal Style Merchandise.* An advertising agent employed by the company, a manufacturer of gingham cloth, conducted a market survey to determine whether the company should advertise its branded ginghams to consumers. The agent submitted a report of the survey and recommended that the company should advertise its brands to consumers.

Advertising—*Advertising Appeals for Seasonal Style Merchandise.* A gingham manufacturing company employed an advertising agency to report on whether the company should advertise its ginghams, some lines of which were branded, to consumers. The report, in recommending a plan of consumer advertising, suggested that the advertisements should emphasize the qualities in ginghams which a market survey had indicated to be of primary interest to women purchasers, and also should emphasize the style elements in connection with the company's brand.

(1920)

In order to determine whether it should advertise its product to consumers, the Hanover Cotton Mills, which manufactured ginghams, engaged an advertising agent in 1920 to make a market survey.

During the preceding 20 years the company's output had included, at any one time, from 5 to 12 lines of ginghams. The company had endeavored to restrict its output to as few lines as possible, since standardization of spinning and weaving lowered the manufacturing cost per yard. At the time the market survey was made, the mill was running at capacity and was producing five lines. Four of those lines were sold under the company's brands; labels bearing the brand names were pasted on the ends of the boards around which the gingham was rolled. The Brayburn brand made up three-fifths of the company's production; the other brands were Egmont, Parisien, and Normandy. Cloth with the Brayburn brand sold in February, 1920, at retail prices of about 60 cents a yard. The retail prices of the other lines at that time were from 25 cents to 40 cents a yard.

The company had been selling its entire output through the

[1] Fictitious name.

Gibbs Company,[2] a textile selling agency. That agency sold about four-fifths of the company's total output to wholesalers for resale to retail stores; one-fifth the agency sold to cutters-up to be made into aprons, children's clothing, and women's dresses. The wholesalers generally were not sympathetic toward manufacturers' brands. The cutters-up had opposed the company's attempts to induce them to feature the brands of ginghams of which the garments were made. Their opposition was based upon the fear that their purchasing position would be weakened if a strong preference for particular brands was developed among consumers. The treasurer of the Hanover Cotton Mills, however, foresaw in the development of such a demand not only a larger and more stable sale of the mill's brands, but also an advantage to the cutters-up because of decreased sales resistance.

Several domestic gingham mills over a period of from 25 to 50 years had acquired prestige for their brands among consumers, not by advertising, but by maintaining the quality and style eminence of their lines. The opinion was prevalent among gingham manufacturers that in most years, because of competition, the manufacturers' gross margins were so small that the expense of advertising would be prohibitive. At all events practically no advertising of gingham brands had been carried on.

The market investigation conducted for the Hanover Cotton Mills by the advertising agent was planned to show the possibilities for the development of brands of ginghams. In conducting his investigation, the advertising agent used two questionnaires, one for retailers and one for consumers. Representatives of the agent interviewed 101 retailers and 1,093 consumers. Retailers were visited in 17 states, classified into sections 1 and 2 as follows:

Section 1	Section 2
Maine	Delaware
New Hampshire	Maryland
Rhode Island	Virginia
New York	West Virginia
Ohio	Kentucky
Indiana	Tennessee
Michigan	North Carolina
Connecticut	Georgia
	Alabama

[2] Fictitious name.

The stores that were visited were classified according to their general character into three groups: "A" was the highest class, "C" the lowest, and "B" the intermediate. Among the consumers interviewed there were about twice as many married women as single women. The consumers' interviews were made in 135 cities, towns, and villages, in 35 states, and were distributed as follows, according to the size of the towns in which they were made:

Population	Interviews
Over 100,000	296
10,000-100,000	434
Under 10,000	363
Total	1,093

In presenting the results of his investigation to the company, the advertising agent drew the following conclusions:

The Hanover Cotton Mills has an unusual opportunity at the present time to build up prestige through advertising. Although some brands are better known than those sold by the Hanover organization, brands of gingham are not generally well known. The knowledge of brands in the gingham field is more or less vague and uncertain, and there is no brand which dominates. Therein lies the opportunity of the Hanover Cotton Mills. By continuous advertising which features the

EXHIBIT 1

BRANDS OF IMPORTED GINGHAMS CARRIED BY 59 RETAILERS INTERVIEWED IN MARKET SURVEY MADE FOR THE HANOVER COTTON MILLS

QUESTION: What Brands of Imported Ginghams Do You Carry?

Brand	Section 1 North Class-Store				Section 2 South Class-Store				Grand Total
	A	B	C	Total	A	B	C	Total	
Smith, M. & H.	6	1	4	11	4	3	1	8	19
Aurora	1	..	..	1	..	..	..	..	1
Donegal	1	..	..	1	..	..	..	..	1
Jones	..	..	..	..	1	..	..	1	1
Brand not given	17	6	5	28	3	3	1	7	35
Totals	25	7	9	41	8	6	2	16	57

NOTE: Figures indicate the number of retailers carrying each brand.

Exhibit 2

Brands of Domestic Ginghams Carried by 101 Retailers Interviewed in Market Survey Made for the Hanover Cotton Mills

Question: What Brands of Domestic Ginghams Do You Carry?

Brand	Section 1 North Class-Store				Section 2 South Class-Store				Grand Total
	A	B	C	Total	A	B	C	Total	
Mallard	1	4	8	13	6	4	3	13	26
Smith, A.	3	4	1	8	8	6	3	17	25
Jones	4	3	7	14	1	3	3	7	21
Pontiac	..	2	5	7	2	7	2	11	18
Ronsay	2	4	..	6	4	3	..	7	13
Wherry	3	4	..	7	1	3	..	4	11
Georgian	..	..	2	2	1	4	1	6	8
Parisien*	1	..	3	4	1	2	1	4	8
Johnson	4	1	1	6	..	1	..	1	7
Egmont*	2	2	1	5	1	1	..	2	7
Rockford	..	..	..	..	1	5	1	7	7
Normandy*	3	1	..	4	..	1	1	2	6
Royal	4	..	..	4	1	..	..	1	5
Brayburn*	..	..	1	1	1	..	2	3	4
Worcester	1	..	..	1	1	1	1	3	4
Durham	..	..	..	..	..	1	1	2	2
Roman	..	..	..	..	1	1	..	2	2
Flower	..	..	..	..	..	1	1	2	2
X Y Z	..	..	..	..	1	..	..	1	1
X A Z	..	..	1	1	..	..	..	..	1
Ashly	1	..	..	1	..	..	..	..	1
Maine	..	1	..	1	..	..	..	..	1
Leona	..	..	..	..	..	..	1	1	1
Indianthrene	1	..	..	1	..	..	..	..	1
Manchester	..	..	1	1	..	..	..	..	1
LaFrance	..	..	..	..	..	1	..	1	1
Norwood	..	..	..	..	..	1	..	1	1
Park	..	..	..	..	..	1	..	1	1
Rose	..	..	..	..	..	1	..	1	1
Rice	..	..	..	..	..	1	..	1	1
Victory	..	..	..	..	..	1	..	1	1
Whittenton	..	..	..	..	..	..	1	1	1
Woodley	..	..	..	..	1	..	..	1	1
Zephyr	..	1	..	1	..	..	..	..	1
1600	..	..	..	..	..	1	..	1	1
Brand not given	17	6	6	29	3	4	1	8	37
Totals	47	33	37	117	35	55	23	113	230

Note: Figures indicate the number of retailers carrying each brand.
*Manufactured by the Hanover Cotton Mills.

things of fundamental interest to women who use ginghams, the company can make its own brand names the equivalents of the qualities which women want in ginghams so that they will come to be household words, as are the names of many other products. The brand names of the Hanover Cotton Mills will be further emphasized by their relation to the style featured. A given style should be definitely connected with a certain brand. The advertisement should specify that in making the dress pictured the best results are to be secured by the exclusive use of this particular brand of gingham. As our important task is to induce a wider and more continuous use of gingham, we must make the woman want to use the gingham and we must make her want especially our particular brands. The present study has shown that the way of accomplishing this result consists of following the hints given by the consumer, getting her judgment on the material, talking to her about stylish dresses, and keeping continually before her the brands of the Hanover Cotton Mills.

The answers received to the questionnaire used for retailers were summarized by the advertising agent as shown in Exhibits 1, 2, and 3.

Every retailer interviewed carried at least one brand of domestic gingham. Most of the retailers mentioned more than one brand.

EXHIBIT 3

RELATIVE IMPORTANCE OF FACTORS DETERMINING CONSUMERS' SELECTION OF GINGHAMS AS REPORTED BY 101 RETAILERS INTERVIEWED IN MARKET SURVEY MADE FOR THE HANOVER COTTON MILLS

QUESTION: What Do You Think Determines the Consumer's Selection of a Particular Gingham?

Factor Determining Selection	Section 1 North Class-Store				Section 2 South Class-Store				Grand Total	
	A	B	C	Total	A	B	C	Total	Number	Percentage
Pattern	15	9	13	37	9	20	6	35	72	38
Quality	9	5	4	18	10	14	5	29	47	25
Style	15	4	5	24	5	1	1	7	31	16
Color	3	3	2	8	4	8	2	14	22	11.5
Price	2	4	..	6	1	1	1	3	9	5
Width of Material	1	..	1	2	..	1	1	2	4	2
Brand	3	..	..	3	..	..	..	..	3	1.5
Durability of Pattern	..	..	..	..	..	1	..	1	1	.5
Feel	1	..	..	1	..	..	..	..	1	.5
Total	49	25	25	99	29	46	16	91	190	100

NOTE: Figures indicate the number of times each factor was mentioned. More than one factor was reported by many of the retailers.

One of the questions in the questionnaire used for consumers was, "What Brands of Ginghams Do You Know?" The answers received to this question are summarized in Exhibit 4. About 40% of the women interviewed did not name any brands of gingham, whereas about 60%, or 652 women, did name various brands. Many of the women named more than one brand.

EXHIBIT 4

BRANDS OF GINGHAMS NAMED BY 652 CONSUMERS INTERVIEWED IN MARKET SURVEY MADE FOR THE HANOVER COTTON MILLS

QUESTION: What Brands of Ginghams Do You Know?

Brand	Times Mentioned	Brand	Times Mentioned
Amazon	1	Leroy	1
Johnson	1	Egmont	2
Pontiac	211	Brayburn	21
Smith, M. & H.	230	Normandy	5
Jones	29	Manville	5
Bridalwreath	6	Muskagee	1
Buckingham	1	Parker	1
Buckley	2	Park	23
Castle	7	Perfection	1
Dan Rivers	16	Peter Pan	3
Dauntless Cloth	22	Worcester	7
Etoile	1	Parisien	43
French	169	Scotch	43
Gibson	11	Sea Island	1
Royal	4	Simpson	11
Golden Rod	4	Standard	4
Hamilton	1	Mallard	27
Roman	6	Treffan	5
Inerseal	8	Zephyr	148
Ronsay	4		
		Total	1,086

The question, "If the Store Advertised Dresses Made of Some Standard Brand of Gingham, Would You Be More Apt to Buy Them Than if the Brand Were Not Mentioned?" was answered by 1,065 women. Of that number, 526, or 49%, answered yes and the remainder, or 51%, answered no.

Of 1,237 consumers answering, 56% said they usually made their gingham dresses themselves; 22% that they usually had their gingham dresses made by dressmakers; and 22% that they usually bought such dresses ready-made.

Consumers also were asked to name the principal and the secondary uses which they made of gingham. Those uses, as reported, are given in Exhibit 5.

EXHIBIT 5

USES FOR GINGHAMS AS REPORTED BY CONSUMERS INTERVIEWED IN MARKET SURVEY MADE FOR HANOVER COTTON MILLS

Principal Uses for Gingham*	Times Mentioned	Percentage	Secondary Uses for Gingham†	Times Mentioned	Percentage
Dresses	830	60	Aprons	559	49
House Dresses	123	9	Covers	100	9
Street Dresses	13	1	Rompers	67	6
Aprons	214	15	Dresses	65	6
Child's Dresses	141	10	Skirts or Underskirts	51	4
Child's Rompers	25	2	House Dresses	46	4
Waists	22	2	Hats, Bonnets, Caps	44	4
Men's Shirts	5	..	Shirts	43	4
Drapery	2	..	Boys' Waists and Suits	38	3
Curtains	1	..	Child's Dresses	38	3
			Play Dresses with Bloomers	27	2
			Curtains	25	2
			Draperies	25	2
			Laundry and Sewing Bags	23	2
			Miscellaneous	9	..
Total	1,376	100	Total	1,160	100

*1,083 consumers reported, in some instances naming several "principal" uses.
†962 consumers reported, in some instances naming several uses.

EXHIBIT 6

RELATIVE IMPORTANCE OF SPECIFIED FACTORS IN PURCHASE OF GINGHAMS FOR CHILDREN'S GARMENTS AND FOR ADULTS' GARMENTS, AS REPORTED BY CONSUMERS INTERVIEWED IN MARKET SURVEY MADE FOR THE HANOVER COTTON MILLS

CHILDREN'S GARMENTS*		ADULTS' GARMENTS†	
Factor	Relative Importance, Percentage‡	Factor	Relative Importance, Percentage‡
Price	55	Price	56
Brand	13	Brand	16
Color	64	Color	70
Fastness of Color	61	Fastness of Color	56
Design	59	Design	65
Quality	66	Quality	70
Durability	56	Durability	44
Shrinkage	26	Shrinkage	23

*581 consumers reported.
†1,068 consumers reported.
‡The consumers were asked to rank the eight factors in the order of their importance for children's garments and for adults' garments. On the basis of those rankings the relative importance of each factor was determined; the maximum possible score for each factor was 100%.

On the questionnaire eight factors which might influence consumers in purchasing gingham were listed. The consumers were asked to arrange those factors in what they believed to be the order of their importance in the purchase of gingham for children's garments and for adults' garments. On the basis of these rankings the eight factors were given the relative values shown in Exhibit 6.

Another question on the questionnaire used for consumers was, "What Criticism Have You of the Ginghams You Have Used?" Six hundred twenty-five women reported criticisms. Exhibit 7 lists those criticisms and shows the number of times each was mentioned.

EXHIBIT 7

CRITICISMS OF GINGHAMS REPORTED BY 625 CONSUMERS INTERVIEWED IN MARKET SURVEY MADE FOR THE HANOVER COTTON MILLS

Criticism	Times Mentioned	Percentage
Fades	340	39
Shrinks	269	31
Colors run	57	7
Too narrow	42	5
Price too high	30	3
Poor quality	19	2
Wear poorly	17	2
Not a cool material	16	2
Do not launder well	13	1
Poor patterns	12	1
Deficient in colors	11	1
Hard to match and not printed straight	11	1
They draw up	10	1
Poor dye	10	1
Get soiled too easily	7	1
Weave not soft enough	5	1
Colors not delicate enough	4	..
Weave not light enough	4	..
Too hard to iron	2	..
Total	879	100

COMMENTARY: A part of the recommendation of the advertising agent reads: "By continuous advertising which features the things of fundamental interest to women who use ginghams, the company can make its own brand names the equivalents of the qualities which women want in ginghams so that they will come to be household words, as are the names of many other products. The brand names of the Hanover Cotton Mills will be further emphasized by their relation to the style

featured. A given style should be definitely connected with a certain brand."

In that statement the advertising agent showed his failure to appreciate the need for differentiating between the various qualities which women want in ginghams. Extensive advertising of particular brands of gingham cloth would not influence consumers to prefer the designs or colors in which those brands were made, while consumers' confidence in qualities such as fastness of color and durability could be enhanced by advertising. Gingham cloth involved a style factor and therefore presented a merchandising problem quite different from that of staple merchandise such as groceries, for example.

One of the chief points in this case depends upon the interpretation that is given the advertising agent's recommendation that "a given style should be definitely connected with a certain brand." Interpreted literally, that recommendation clearly is inconsistent with the merchandising of seasonal style goods. Inasmuch as styles change from season to season, there would be no continuity of brands and little opportunity for establishing a brand reputation. Such a policy also would involve such a multiplicity of brands that it is not deserving of serious consideration.

The major recommendation, that the company should enter upon an advertising program which would place its brands in a dominating position in the trade in ginghams, purports to be based on the results of the market survey which is therewith reported. It is proper, therefore, to examine the recommendation in the light of the facts stated in the report on the survey.

The question, "What Brands of Domestic Ginghams Do You Carry?" was answered by 101 dealers, who reported 230 brands carried, including many duplications, of course. That was an average of approximately two brands per store. The four brands of the Hanover Cotton Mills, however, were reported in only 25 instances, or, if the average is applied, by only 12 stores. If this report was based on a typical sample, then the Hanover Cotton Mills had poor distribution and its sales and advertising programs should have been planned with a view to improving this condition. The advertising program for a company with poor distribution is quite different from that for a company with good distribution. If the survey did not cover a typical group of stores, then its dependability is open to doubt.

The fact that 25 of the brands mentioned by consumers (Exhibit 4) were not included in the list of brands carried in the stores visited (Exhibit 2) might raise a further question as to the dependability of the survey. Such a discrepancy as this should at least have been explained in the report.

The answers to the question, "What Do You Think Determines the Consumer's Selection of a Particular Gingham?" show that pattern, quality, style, and color were predominant; brand was of little influence. The replies obtained from consumers as to the relative importance of various considerations in the purchase of ginghams likewise indicated that brand was of minor consequence. The answers to the question, "What Brands of Ginghams Do You Know?" however, seem to prove that the relatively slight influence of brand on consumers' purchases of ginghams was not the result of ignorance of brands.

From the evidence just referred to, there seems to be a clear implication that consumers prefer to select patterns, styles, and colors which please their taste, with only secondary consideration of the brands on the cloth. Gingham cloth is a typical shopping good and this process of selection of merchandise by consumers is typically shopping. Hence, the facts in the survey indicate that should the Hanover Cotton Mills have attempted by advertising to make its brands dominate the consumers' minds to a point where they would insist on Hanover brands, its advertising would have run counter to ingrained buying habits and motives and would have had small chance for success.

The information obtained from this survey indicated that in its advertising the Hanover Cotton Mills should have associated such qualities as fastness of color and non-shrinkage with its brands. Those were qualities desired by consumers and they could not be judged by inspection at the time of purchase. If consumers could rely upon the company's brands to give satisfaction regarding those qualities, then when the company's patterns, styles, and shades were as attractive as those of competitors, the company could expect consumers to prefer the Hanover brands. Unless the patterns, styles, and shades were equally attractive, however, it was not reasonable to expect a brand reputation or extensive advertising to offset a primary advantage enjoyed by competitors.[3] Advertising cannot be relied upon to take the place of skill and judgment in designing. For shopping goods advertising performs a different service from that which it renders for convenience goods or specialty goods.

November, 1925 M. T. C.

[3] See also in this connection the case and commentary of the Margate Company, 2 H.B.R. 182.

L. P. Paxton Company[1]

MANUFACTURER—SHIRTS

Merchandising—*Shifting of Style Risk from Manufacturer to Converter.* A manufacturer of high-grade shirts was offered, by a converter, several fancy patterns of figured cotton broadcloth. The converter stated that those patterns were being purchased extensively. The company ordinarily desired to have several exclusive style patterns in its line of samples. The converter's offerings were considered suitable novelties for the company's line. Although the converter refused, because of the style risk, to make up stocks of the patterns subject to the company's orders as needed, the company decided to purchase a supply of the patterns.

(1922)

The purchasing agent of the L. P. Paxton Company, while in New York in the spring of 1922 for the purpose of buying cloth for the company's fall line of shirts, was shown by a large converter several fancy patterns of figured cotton broadcloths which the converter said were being purchased extensively. The purchasing agent asked the converter to furnish him with enough material of the fancy patterns to make up a sample line of shirts and to agree to maintain sufficient stock to fill reorders for the material. This, however, the converter was unwilling to do, since it would involve the risk of having a surplus stock of seasonal style merchandise left on his hands. The purchasing agent then had to decide whether to order a supply of the broadcloths.

The L. P. Paxton Company purchased grey cotton cloth through brokers, fabrics with woven designs from mills or mill selling agents, and bleached and printed fabrics, such as were offered in this instance, from converters. The cloth which the company purchased in the grey was converted on the company's account and finished in accordance with its specifications. The company bought designs from several New York designers, ordinarily paying $3 for patterns of one color and more for patterns of two or three colors. These designs, which were merely drawings, were sent to the finisher, who engraved them on copper rolls which became the property of the L. P. Paxton Company. This converting was undertaken by the company usually in

[1] Fictitious name.

order that it might have exclusive patterns, or at least patterns which could not be copied in less than six or eight weeks.

The company's orders for grey cloth were placed through brokers who specialized in the kinds of fabrics that the company used. The company usually confined its purchases to two or three grey goods mills, the products of which were of a known standard of quality, although it solicited offers from several brokers. The purchasing agent did not buy directly, since most of the mills sold as cheaply through brokers as they did directly. In most instances the broker was allowed his 1% commission by the mills on direct sales to his customers. The buyer for the L. P. Paxton Company also believed that it was to his advantage to buy through brokers inasmuch as he did not have time to keep in constant touch with the market. By securing competitive bids from brokers who were thoroughly familiar with the market, he believed that he usually obtained the lowest prices. In buying grey goods, it was necessary to buy in warp lengths of from 100 to 110 pieces, 60 yards to a piece. This cloth was bought on terms of 2%, 10 days, net 60 days. From 6 to 8 weeks were required for the converting process.

In buying cloth with woven patterns, the company placed its orders directly with the mills or their selling agents. To secure an exclusive pattern the company was obliged to buy a minimum of about 55 pieces, 60 yards to a piece, of the pattern. At least two months were required for the run of a pattern. The terms were similar to those for grey cloth. Purchases could be made in lots of from 8 to 10 pieces if exclusive rights to the pattern were not desired.

The company also ordinarily could purchase converted fabrics in lots of from 8 to 10 pieces from converters, but received no exclusive rights to the patterns. Converters bought cotton cloth in the grey, that is, unfinished as it came from the looms. They then had the grey cloth bleached, singed, printed, or dyed, according to their specifications.[2] The converters developed patterns which they expected to sell for various purposes, some converters specializing in shirt materials, others in dress goods. When these patterns were made up into samples, orders were secured from cutters-up, such as the L. P. Paxton Company, and from

[2] See Bureau of Business Research, Harvard University, Bulletin No. 56, *Distribution of Textiles,* pp. 39, 41.

wholesalers, and the cloth, which had been stored in the warehouse of the finishers, was ordered to be finished. Most converters did not operate finishing plants, but had the goods finished on commission by companies organized for that purpose. The converters either bought the designs from professional pattern designers or had them developed in their own designing rooms. The designs were then sent to the finishers where they were engraved on copper rollers. One roller was required for each color appearing in a design. This engraving process required approximately two weeks, an interval about equal to the usual time that the grey cloth was in transit from the cotton mills to the finishing works. The finishing of grey cloth in accordance with the order of a converter required from five to seven weeks.

A minimum order customarily accepted by a finisher was approximately 10,000 yards. The price paid for the finishing was on a yard basis and varied according to the amount of work required. Bleaching, for instance, incurred the lowest charge, while the charge was highest for printing several colors. An allowance of 2½% was made to the finisher for imperfections and shrinkage in the finishing process. Thus, if 10,000 yards were sent to the finisher, he was required to deliver only 9,750 yards of finished goods.

The converter who showed the fancy patterns to the purchasing agent of the L. P. Paxton Company in the spring of 1922 was operating a typical converting business. The price which he quoted on the fancy broadcloth was 63 cents a yard. This was from 15 cents to 18 cents higher than the price of the same kind of cloth finished in plain white. The cost of converting the fancy broadcloth, as the purchasing agent knew, was about 6 cents or 8 cents a yard above the cost of finishing plain white cloth. The patterns, however, were so original and of such fancy style as to make the converter's risk greater than for plain material or for less fancy patterns. Since the patterns were shown in confidence by the converter, the buyer was not free to have them imitated by his company's designers, although it was probable that, if figured shirts became popular, many imitations would be brought out soon after the goods appeared on the open market.

The L. P. Paxton Company estimated that if it made shirts of this fancy broadcloth the retail price would be about $5 each. Since the prevailing mode for the preceding three or four seasons

had been white, consumers might be unwilling to pay so high a price unless there was a decided style swing toward the use of fancy patterns in shirts. After returning to the factory, the buyer consulted with the company's salesmen and branch managers, and also with retailers, and concluded that patterns of figured and striped materials would be moderately popular in the autumn. Since the Paxton line had a reputation for style leadership, it seemed essential that it should contain some fancy numbers. If the demand materialized, as predicted by the converter, and the L. P. Paxton Company was not prepared for it, there would be a delay of at least six weeks before orders for shirts in fancy patterns could be filled. If, however, the demand materialized and the company was prepared, it would be in a favorable position because the gross margin on such novelty lines was larger than on staple numbers. The reputation of the company for style leadership also would be enhanced. If a large order were placed and the demand did not materialize, the shirts would have to be sold at reduced prices and the company would be obliged to take a loss of from 20 cents to 30 cents a yard on all its purchases of fancy cloth.

Another objection to a purchase of the fancy broadcloths was that other manufacturers might use that cloth in making shirts of a grade inferior to that of the L. P. Paxton Company's shirts. Manufacturers, by cutting the shirts 28 yards instead of 32 yards to the dozen, could make them up to sell for $2 or $3 less per dozen than the Paxton Company would be obliged to ask. Although this smaller yardage would detract from the fit of the cheaper shirts, there would be no readily observable differences between those shirts and the Paxton line when they were folded for display. Those other shirt manufacturers also were likely to use lower quality buttons, thread, and workmanship on the shirts. Because the patterns were fancy, attention would be called to the difference in price between shirts made by the L. P. Paxton Company and those made up more cheaply; and, except among those consumers who readily could appreciate the difference in quality, the Paxton shirts would acquire an unwarranted reputation for high price.

Despite the risks that were involved, the buyer decided to place an order with the converter for the figured broadcloths.

Commentary: The central point in this case is the request which the buyer made that the converter permit him to buy enough cloth of the fancy patterns to make up a sample line of shirts and protect him on reorders. The buyer was seeking to obtain a substantial advantage in being able to include the fancy patterns among the company's samples and at the same time to avoid the risk of loss from style depreciation if the patterns did not prove to be popular.

Inasmuch as the converter had incurred the expense of preparing the patterns, he clearly was warranted in exploiting them as fully as possible. He had assumed the initial risk, and he should have retained a free hand for disposing of his entire stock expeditiously. The L. P. Paxton Company, furthermore, was seeking to maintain style leadership. That position required that the company carry the risk of introducing new patterns. The company could not properly expect to shift that risk while retaining leadership. The buyer undoubtedly recognized these facts and did not actually expect the converter to grant his request.

October, 1925 M. T. C.

Henry B. Leland Company[1]

RETAILER—SHOES

Merchandising—*Premature Purchase of Style Merchandise.* The company, which operated a retail shoe store in a town in the Middle West, placed an order during the depression that followed the crisis of 1920 for a style of shoes which was just becoming popular in the large eastern markets. The firm hoped thereby to stimulate lagging sales. Subsequent experience proved that the purchase of that style was premature, for it did not achieve popularity until a later season, after the firm had sold at a loss the shoes received on the above order.

(1920)

On a buying trip to New England in September, 1920, Henry B. Leland, a shoe retailer of Castalia, Iowa, visited shoe factories in Brockton, Massachusetts. One of Mr. Leland's chief objects on this trip was to secure information regarding style tendencies. At several factories Mr. Leland was shown men's shoes of the style known as fancy brogues, which then were popular in the large eastern cities. The manufacturers urged Mr. Leland to include brogues in his selection of merchandise to supplement his other lines for the autumn of 1920 and to make plans to put in a large stock of brogues for the following spring season.

Castalia, a town of 15,000 inhabitants, was the buying center for a normally prosperous agricultural district. Several small manufacturing enterprises were located there, but factory workers constituted only a small proportion of the population. The Henry B. Leland Company sold men's, women's, and children's shoes of medium grades, and in 1919 had net sales amounting to $65,850. There were four other shoe stores in the town, two of which were larger and two smaller than the Leland store. Two department stores in Castalia also sold shoes.

Mr. Leland regularly had placed his largest orders for shoes twice a year, in anticipation of the two main selling seasons. These orders usually were given to traveling salesmen representing manufacturers or wholesalers. During the course of each season Mr. Leland generally had found it necessary to place fill-in orders, usually with wholesalers. The store never had made it a

[1] Fictitious name.

policy to feature novelty styles. When the vogue for colored kid shoes for women had reached Castalia, about one year after they had begun to sell popularly in New York, Philadelphia, and Boston, those styles had been featured successfully by other shoe retailers in Castalia, especially by the two local department stores, before Mr. Leland had realized the strength of the demand for them. He had decided then not to overlook important style developments in the future.

Retailers in Castalia, in common with retailers in most parts of the country, had felt the effects of the so-called "buyers' strike" in the spring and summer of 1920. Mr. Leland had cancelled part of his fall orders, reduced prices gradually, and bought cautiously in filling in his summer lines. Shoe retailers' trade papers at that time had begun to emphasize the necessity of achieving a more rapid rate of stock-turn and had urged shoe merchants to buy small lots of the latest styles in order to stimulate sales of their old stocks. Predictions were freely made that style would be one of the chief factors in the spring trade of 1921. It was apparent to Mr. Leland at that time that style novelties were constituting a considerable part of his sales of women's shoes.

Mr. Leland placed orders for fancy brogues in accordance with the recommendations of the manufacturers. The sales of the new style were small in Mr. Leland's store during the spring season in 1921, despite the fact that no other store in the city offered the style. At the end of the season Mr. Leland closed out his stock of brogues at a loss. During the next season, however, a substantial demand for brogues developed in Castalia.

COMMENTARY: The results in this case are what might have been expected. We are not concerned here with the question of how a new style originates, but rather with the manner in which it spreads. This case illustrates the course of its spread in one direction—from the metropolitan markets to smaller cities and towns. The spread of a new style is caused chiefly by the buying motive of emulation. Obviously, then, the new style must be established at some point before the buying motive of emulation can become operative. In this instance the style was too new for the customers of Mr. Leland's store to be acquainted with its coming popularity; hence they were not prepared to respond to the motive of emulation.

This experience illustrates the fact that in merchandising seasonal style goods it is as disadvantageous to purchase a new style prematurely as it is to overstay the market, as was done by the Cascade Department Store.[2] The essence of success in style merchandising lies in timing the entry into and exit from the market for each style so as to exploit its popularity fully. The proper time for entry and exit is not the same for all types of stores or, as this case indicates, for all localities.

November, 1925 M. T. C.

[2] See page 287.

PHIPPS HOSIERY COMPANY[1]

MANUFACTURER—HOSIERY

PRODUCT ADAPTATION—*Change from Staple Product to Style Product to Meet Consumer Demand.* The company was well known as a manufacturer of durable, low-price hosiery. The growing importance of style and variety as consumer buying motives for hosiery led the company to manufacture and direct its sales emphasis to hosiery designed to meet those requirements.

PRODUCT ADAPTATION—*Change of Product to Meet Consumers' Desire for Economical Emulation.* The company was well known as a manufacturer of durable, low-price hosiery. Because of the growing consumer demand for varied and stylish hosiery, the company began to manufacture, for sale at comparatively low retail prices, hosiery resembling high-price style goods then on the market.

ADVERTISING—*Selection of Appeals.* The company, an established manufacturer of durable, low-price hosiery, began to manufacture hosiery designed to appeal to consumers' demand for style. That hosiery sold at comparatively low retail prices. In its advertising of the new hosiery the company emphasized both style and price.

(1923)

In 1922 the Phipps Hosiery Company, located near Philadelphia, was well known for the durable, low-price hosiery which it had been manufacturing for more than 20 years.[2] The company manufactured men's half-hose to retail for 15 cents to 35 cents a pair, children's stockings also to retail for 15 cents to 35 cents a pair, and women's stockings to retail for 25 cents to 75 cents a pair. Durability, low price, and comfort were the outstanding characteristics of Phipps hosiery.

The executives of the company realized that in the decade preceding 1922 there had been a marked change in the character of consumers' demands for hosiery. The executive had observed that women of the type which in 1910 purchased comfortable, durable, black stockings made of combed cotton yarn or of lisle yarn, were demanding, in 1922, silk stockings in many colors, woolen stockings for sport wear, and stockings of wool and silk

[1] Fictitious name.

[2] See also Phipps Hosiery Company, 2 H.B.R. 35.

mixtures, decorated with clocks and fancy stitches. This changed character of demand was hampering seriously the sale of Phipps hosiery. The executives, consequently, contemplated undertaking the production of hosiery of greater variety and higher quality in an effort to appeal to what they believed had come to be the chief buying motives for hosiery.

When the mills of the Phipps Hosiery Company were producing at capacity, 60% of the hosiery manufactured was for women, 25% for men, and 15% for children. All hosiery produced by the Phipps Hosiery Company was seamless. A seamless stocking was knitted on a circular machine and was made in one unbroken piece. The stockings produced on most seamless machines had the same number of stitches in the ankle as in the leg. Prior to 1918, a seamless stocking was shaped by shrinking the ankle, placing the stocking on a form, and applying steam. This process had not been altogether satisfactory; seamless stockings had tended to lose their shape after they had been laundered several times. From 1918 to 1923, machinery for making seamless hosiery had been improved so that the yarn was knitted under greater tension at the ankle than at the top, with the result that, although there was the same number of stitches at the ankle as in the leg, the stocking was shaped permanently. In addition, a mock seam was sewed down the back, so that in appearance a seamless stocking resembled closely a full-fashioned stocking.

A full-fashioned stocking was knitted on a flat machine, fashioned to the proper shape, and then sewed together. Thus, such a stocking had a seam extending down the full length of the back. In that they fitted the ankle better and permanently held their shape, full-fashioned stockings were greatly superior to the old type of seamless stockings. The difference between full-fashioned stockings and the improved type of seamless stockings, however, was by no means so great. Inasmuch as machinery for full-fashioned hosiery was more expensive than machinery for seamless hosiery and could not produce so many pairs of stockings in a given time, and since labor costs were much greater for full-fashioned stockings, full-fashioned stockings sold for higher prices than did seamless stockings. The executives of the Phipps Hosiery Company were not convinced that the superiority of full-fashioned stockings to seamless stockings made by the most im-

proved methods was sufficient, from the consumer's point of view, to justify the price differential. It was apparently true that many consumers did not know the real differences between full-fashioned and seamless stockings, but only that the former were supposed to fit better.

Coincidently with the changing character of consumer demand for hosiery from 1910 to 1922, sales of full-fashioned stockings as compared with sales of seamless stockings had increased appreciably. In 1923, however, because of the improvements which had been made in the manufacture of seamless hosiery, there appeared to be a real question as to whether this tendency was to continue. At that time, the company estimated that about 25% of the hosiery sold in the United States was full-fashioned and about 75% seamless. The executives were of the opinion that there was an excellent opportunity for an established manufacturer of seamless hosiery to produce stylish and attractive hosiery to retail at prices lower than the prices of full-fashioned stockings.

In order to take advantage of that opportunity, the executives, in 1923, decided to place the entire sales emphasis upon hosiery made to retail for 75 cents and $1 a pair. Women's stockings of pure silk and fiber silk and men's half-hose of pure silk were leading styles which retailed for $1 a pair. Women's stockings made of a wool and cotton mixture sold at retail for 75 cents a pair; the same style with fancy clocks sold for $1. The company produced men's half-hose of gassed mercerized cotton yarn to retail for 50 cents a pair. In addition it made a small quantity of men's half-hose of high-quality wool to retail for $1.25 a pair, and a small quantity of women's pure silk stockings to retail at $1.50. The company continued to produce the cheaper grades of men's and women's hosiery to retail at prices from 25 cents to 75 cents, but devoted little sales effort to those grades. The company produced children's hosiery to sell at retail for 25 cents to 50 cents a pair. In 1923 there were about 19 styles of Phipps hosiery for women, 7 styles for men, and 4 styles for children. The number of shades in which stockings of the different styles were made varied. The standard pure silk and fiber stockings for women were made in 22 shades, mostly greys and browns. Some of the other style numbers were made in fewer shades.

The company instituted a campaign of national advertising for its new quality of hosiery, which was called Monarch Phipps. The following statements illustrate the selling points stressed by the company. An advertisement appearing in a trade magazine regarding the new type of hosiery manufactured by the company announced that: "Trim fit, luster, fashionable colors, strength, and good style are the characteristics necessary in hosiery for the well-dressed woman. Such are the characteristics of Monarch Phipps hosiery and yet they retail for $1 a pair. Every woman who has weighed good looks with economy will find remarkable value in this hosiery. The beautiful packing is as attractive as the hosiery. Monarch Phipps includes stockings not only of pure silk reinforced with fiber but also of clocked wool and cotton mixtures. Long experience and volume production enable the Phipps Hosiery Company to offer handsome hosiery for $1 a pair."

An advertisement which the company inserted in a leading national weekly was headed: *"Do You Desire Remarkable Value? One Dollar a Pair of Monarch Phipps Hosiery."* This heading was followed by these statements: "One dollar a pair solves the problem of securing handsome hosiery to match your shoes and frocks. Monarch Phipps gives assurance that your stockings are designed to prevailing style, are lustrous, sheer, and beautiful. You may purchase these long-wearing, trim-fitting stockings for $1." Another advertisement was headed: *"One Dollar Secures the Characteristics of Expensive Hosiery."* This advertisement went on to say: "Do you appreciate the fact that it is no longer necessary to pay high prices and that $1 will purchase a pair of stockings of high quality and good looks?" In another advertisement addressed primarily to men, these statements were made: "Your wife knows she can obtain remarkable value in Monarch Phipps hosiery. You can secure the same satisfaction and economy in socks of pure, heavy silk, in silk and fiber, and in wool and cotton mixtures."

COMMENTARY: The company's advertising plan in general was suited to the product. The factory which the company operated was equipped to produce hosiery lower in cost and less popular in style than full-fashioned hosiery. This circumstance did not preclude the entry of the company into the manufacture of style merchandise; but it did render

it necessary for the company to cater to a different market, to operate in a later stage of the style cycle. The dominant buying motive to which the company could appeal was economical emulation, that is, to the desire of consumers to keep up with styles without paying high prices.

In the company's advertising, the emphasis should have been primarily on style, with prominent reference to price. This objective was partially attained in the advertisements quoted. The second advertisement, however, would have been stronger if some phrase such as *Hosiery to Match Your Shoes and Frocks* had been substituted in the headline for *Do You Desire Remarkable Value?* The fact that the company found it advisable to change its output from staple goods to style merchandise proves that style came first in the minds of the consumers who purchased Phipps hosiery; price was secondary.

April, 1926 M. T. C.

Bowman Company[1]

DEPARTMENT STORE—RUGS

MERCHANDISING—*Introduction of New Line of Competing Goods.* The buyer for the rug department of the company's department store was undecided whether to buy 18 Wilton rugs or to buy 12 Wilton rugs and 6 rugs of a type just placed on the market. Rugs of the new type, unlike Wilton rugs, were seamless. They were slightly higher in price than Wilton rugs of comparable quality and size, and the assortment of colors and patterns was smaller. The manufacturer was willing to give the company the exclusive agency for the rugs in its city if the company purchased 6 immediately.

(1921)

In November, 1921, the buyer for the rug department of the department store operated by the Bowman Company went on a buying trip to place orders for rugs to be delivered in April and May, 1922. He learned that the Norris Rug Company,[1] of Worcester, Massachusetts, was producing a new type of rug under the name of Belgian Tufted Fabric. This rug, which was manufactured only in the 9 by 12 size, resembled a 13-wire Wilton rug as to quality, but was seamless instead of being made in 4 sections stitched together as was a Wilton rug. The rug department of the Bowman Company's store had established a reputation for carrying medium-grade rugs in a wide variety of colors and patterns. The sales records for that department indicated that $135 was the most popular selling price for 9 by 12 rugs, although the store sold rugs of that size at prices ranging from $75 to $250.

The Bowman Company's store was located in Atlanta, Georgia, and sold a medium grade of merchandise. A majority of the store's customers were white, although a substantial volume of sales was made to the negro population.

The Norris Rug Company had enlarged its factory in order to accommodate the large looms required to weave the one-piece rugs. Although it was the first company to produce seamless rugs, it held no patent on the process or the machinery, and other rug manufacturers probably soon would install the necessary

[1] Fictitious name.

looms, provided that the seamless rugs proved to be popular.

The buyer for the Bowman Company was shown six sample Belgian Tufted Fabric rugs in a variety of colors and designs. The president of the Norris Rug Company was enthusiastic about this new product and talked personally to the buyer. The president stated that the elimination of seams probably doubled the wearing quality of the rugs. The buyer admitted that practically 75% of the complaints that he had received concerning Wilton rugs during his nine years' experience in rug departments had been to the effect that the rugs showed wear along the seams while the bodies of the rugs still were unworn. The seamless feature added to the attractiveness of the rugs, since there were no seams to mar the smoothness of the rugs' surfaces. The president stated that eventually better material could be used in these rugs than in Wilton rugs sold at the same prices, since the expense of sizing and stitching was eliminated by the new process, and since this saving would more than offset the initial expense of installing the necessary new machinery.

The net cost of the 9 by 12 seamless rugs delivered at the Bowman Company's store would be $93.80 each. The normal rate of mark-up in the rug department was 33% of the selling price. If this rate were applied, the rugs could be sold at retail for $140 each.

The seamless feature of the rugs appealed to the buyer, but he was not favorably impressed by either the colors or the patterns of the samples shown. The salesman for the Norris Rug Company said that he just had received an order from one of the largest department stores in Boston for 24 seamless rugs made up in the colors and patterns of those samples. The buyer replied that, because of territorial differences in demand, rugs of a color and pattern which sold readily in Boston often could not be disposed of except at a sacrifice in Atlanta. The salesman admitted that the assortment of colors and patterns in which the seamless rugs were made still was limited, but stated that the seamless feature would offset this slight disadvantage. The buyer, however, believed that customers were more interested in the colors and designs of rugs than in any other factors. He stated that a rug in colors and pattern which appealed to his clientele could be disposed of almost regardless of quality or of

price. On the other hand, a rug of exceptional quality was very difficult to dispose of at any price if the colors and pattern did not appeal to consumers.

Before the buyer was willing to place an order for the Belgian Tufted Fabric rugs he looked at Wilton rugs similar to the ones which had sold satisfactorily in his department during the preceding year. A high-grade Wilton rug comparable to the seamless rugs in quality and more desirable in the buyer's estimation as to colors and design could be bought for $82.50, to retail for $135 if the usual gross margin were obtained.

The president of the Norris Rug Company was eager to secure distribution of the seamless rugs and offered to give the Bowman Company the exclusive agency for those rugs in Atlanta if the buyer would order six of them immediately. The president assured the buyer that within a year the assortment of colors and patterns would be as good in the seamless rugs as in Wilton rugs.

The buyer had planned to purchase 18 9 by 12 Wilton rugs to retail for $135 each. After his talk with the president and the salesman of the Norris Rug Company, he was undecided as to whether he should buy 18 Wilton rugs or 12 Wiltons and 6 Belgian Tufted Fabric seamless rugs. He was of the opinion that the store might be unable to secure the exclusive agency for the seamless rugs later.

Commentary: The question in this case was regarding the relative influence of appearance—color and design—and durability as buying motives. The difference in price between the two types of rugs was too small to sway the purchase in either direction. Both attractive appearance and durability are desirable qualities in such articles as rugs, but in this instance the less durable articles had the more desirable colors and patterns. If both types of construction were equally well known to consumers, the rugs which were the more attractive in appearance, even though less durable, would be chosen by many consumers. The customers of the Bowman Company, however, were familiar with Wilton rugs and unacquainted with Belgian Tufted Fabric rugs; hence they would not have felt themselves at a disadvantage in purchasing Wilton rugs although the Belgian Tufted Fabric rugs were stated to have superior wearing qualities. Those consumers, furthermore, who found the appearance of the Belgian Tufted Fabric rugs unattractive would be deterred rather than stimulated to purchase by reference to the durability of those rugs, for they would not look forward with

pleasure to living for a long period of time with rugs of which they did not enjoy the appearance.

The offer of the exclusive agency should not have influenced the Bowman Company's buyer. During the initial period, the Belgian Tufted Fabric rugs would have been harder to sell than Wilton rugs, hence a less advantageous purchase for the store. By the time that the Norris Rug Company had developed attractive patterns, it was quite possible that other manufacturers would be producing equally attractive rugs of the same type. A purchase of Belgian Tufted Fabric rugs, therefore, was not advisable for the Bowman Company in November, 1921.

July, 1926 M. T. C.

Jordan Watch Company[1]

MANUFACTURER—WATCHES

Advertising—*Selection of Appeals.* Some of the competitors of the company, which manufactured high-grade watches, stressed, in their advertisements, the durability of their timepieces, and some emphasized style. The company planned to advertise its watches extensively in national mediums and had to determine whether to make use of a seasonal style appeal or to stress durability.

(1922)

The Jordan Watch Company for more than 20 years had manufactured men's and women's high-grade watches, making cases as well as movements. These watches were sold in jewelry stores, and the retail prices ranged from $60 upwards. The firm had spent much time and had incurred heavy expense in perfecting its product. It had reason to believe that Jordan watches were fully as dependable and durable as were the products of any other American watch manufacturer. In 1922, being fully satisfied as to the quality of its product, the company planned to inaugurate an extensive program of advertising in national mediums.

One of the strongest competitors of the Jordan Watch Company in sales work and advertising had stressed the accuracy and dependability of its timepieces. An advertisement published by another competitor, however, in a jewelry trade paper in 1921 stressed style and read as follows:

Today It's Style That Sells

There is no use denying the tendency "to go without things" that exists today.

Many a man has said to himself, "I'll wear the old watch a little longer and won't buy the new one just yet."

There is just one thing that will move him to get out of that "won't buy" attitude and decide to purchase the new watch NOW.

That one thing is a stylish case and dial design that just exactly strikes his fancy and arouses his desire to carry that particular watch.

Of course he wants to be sure of accuracy and service at the

[1] Fictitious name.

same time and will not buy an unknown, unstandardized timepiece which has nothing to recommend it but design.

But style is the thing that swings the sales quickly. The jeweler who features . . . . watches in the late models with the new 1921 dial and case originalities is splendidly equipped to get this business and he knows that . . . . accuracy may be depended on to keep the customer permanently satisfied.

Write for colored illustrations of new dial effects. Get this added stimulus behind your watch business now.

The style appeal also was used by a prominent maker of watch cases in the following advertisement appearing in another jewelry trade paper in 1921:

NEW STYLES BUILD NEW BUSINESS

The new motor cars are known as 1922 MODELS.

Merchants who sell clothing, shoes, and hats, will soon be announcing "THE NEW SPRING STYLES."

If we American Jewelers are to sell more watches, we must display new watch merchandise, advertise new watch styles, and educate the public to lay those old heirloom watches away in the "memory chest" beside Grandfather's civil war uniform and Grandmother's wedding dress.

In planning its advertising, therefore, the Jordan Watch Company had to determine whether or not to stress such a style appeal for the watches which it manufactured.

COMMENTARY: Jordan watches were dependable in use and were durable. A seasonal style appeal would have involved an inherent conflict with those buying motives, for the company could not with good grace commend its watches for their long and dependable life and at the same time urge consumers to scrap their watches in order to keep up with the fashion. Even though the company could not advisedly use the seasonal style appeal, however, it could stress the artistic appearance of its watches, backed up by durability and dependability in use. Artistic taste is not inconsistent with durability.

March, 1926

M. T. C.

Dartmore Pen Company[1]

MANUFACTURER—FOUNTAIN PENS

Distribution Channels—*Selection of Retail Distributors for Lower-Grade Product Added to High-Grade Line.* In order to meet competition, the company, which manufactured fountain pens of high quality, decided to manufacture and sell fountain pens of lower grade and price. The company was undecided whether to rely for distribution of its new product upon retailers selling its high-grade pens or to attempt to secure distribution in retail stores selling lower grades of merchandise.

(1920)

At one time the Dartmore self-filling fountain pen was practically the only one of that type on the market. In 1920, however, similar pens were made by several manufacturers. Dartmore pens were carefully manufactured of the best materials, and the total output was not large. In its sales promotion work the company emphasized the self-filling and non-leakable features of its pens. Dartmore pens were sold by jewelers and high-grade stationers; in some instances the manufacturer granted exclusive agencies. Dartmore pens always had been in the high-price class; retail prices in 1918 ranged from $6 upwards. Many Dartmore pens sold in jewelry stores were handsomely mounted with gold or silver and were popular for gift purposes.

Prior to 1920 several competing firms had begun to manufacture self-filling, non-leakable pens which were sold at retail prices lower than the prices of Dartmore pens. The Dartmore Pen Company no longer could claim exclusive advantages for its product. Therefore, early in 1920, the company made plans to produce a self-filling, non-leakable pen in large quantities to be sold at retail prices ranging from $1.50 to $3. This new pen was to be of the same construction as the old one, but standards of materials and workmanship were not to be so high. Because of the lower price it was believed that the new pen would meet competition successfully.

In marketing this new pen, the company was undecided whether to rely for distribution upon the stores that already were

[1] Fictitious name.

selling its other line of pens or to attempt to obtain distribution also in stores selling lower grades of merchandise.

COMMENTARY: It clearly was necessary for this company to seek distribution for the lower-price pens in a much larger number of stores than were selling its high-price pens. There would be an advantage to be sure in restricting distribution to the old customers, among whom the company was well and favorably known, who were of good credit standing, and from whom orders probably could be secured with minimum sales effort. The experience of several other manufacturers who have put out new products that had to be sold to other groups of retailers than those selling the remainder of the lines has shown that much greater sales resistance is likely to be encountered in opening new markets than in selling the new products to the established customers.

The lower-price pen, however, could be sold chiefly to a stratum of consumers who would commonly patronize stores of a different type from those in which the company's high-price pens were sold. For cheap pens, furthermore, the company could expect consumer preference only and, consequently, dense distribution was desirable in order to avoid loss on sales through substitution in retail stores.

The wisdom of the policy of putting out the lower-grade product is an issue which is not raised in this case. That policy involved trading down. This case illustrates one of the effects on methods of marketing of trading down when that action carries the product into a different class from that in which the company's products previously have belonged.

October, 1925 M. T. C.

BEECH-NUT PACKING COMPANY *v.* P. LORILLARD COMPANY[1]

MANUFACTURERS—FOOD AND TOBACCO PRODUCTS

TRADE-MARKS AND TRADE NAMES—*Commercial Use as Prerequisite to Registration.* A company which manufactured a wide variety of foods but which did not manufacture or sell cigarettes sought to register a trade-mark for cigarettes. The United States Commissioner of Patents refused the registration, holding that right to a trade-mark for a particular class of goods can be established only through actual commercial use of that trade-mark on that class of goods.[2]

TRADE-MARKS AND TRADE NAMES—*Ownership for Products of One Class as Not Establishing Ownership for Dissimilar Products.* A company which manufactured various food products brought action in the United States District Court of New Jersey to obtain an injunction enjoining a manufacturer of tobacco products from using on those products the same trade name that the plaintiff used on its food products. The court held that food products and tobacco products were "merchandise of different descriptive properties" and that the plaintiff by establishing its right to use the name on foods had not thereby established its right to use the name on tobacco products also.[2]

TRADE-MARKS AND TRADE NAMES—*Change in Label as Not Constituting Abandonment.* In a suit brought in the United States District Court of New Jersey to enjoin a manufacturer from further use of a trade-mark, the court held that the defendant had been justified in modernizing the label in which its trade name appeared and that in so doing the defendant had not abandoned its right to the trade name.[2]

TRADE-MARKS AND TRADE NAMES—*Disuse as Not Constituting Abandonment.* In a suit brought in the United States District Court of New Jersey to enjoin the defendant from further use of a trade-mark, the court held that the defendant's action in not using the trade-mark for a period of three years had not constituted abandonment, since the defendant's intent to abandon had not been established.[2]

TRADE-MARKS AND TRADE NAMES—*Use of Family Trade-Mark—(Commentary).* In a suit brought by a manufacturer of food products to enjoin a manufacturer of tobacco products from further use of a trade-mark similar to that used by the plaintiff, the court held the defendant not to have invaded the rights of the plaintiff, citing the doctrine that the right to use a trade-mark is confined to "merchandise of the same descriptive properties." In view of the development of "family" trade-marks for merchandising purposes, this doctrine should have been interpreted more

[1] 299 Fed. 834.

[2] Headnote by Graduate School of Business Administration.

liberally by the court and the plaintiff should have been given protection; the question of whether the commodities of the defendant and the plaintiff were sold by the same classes of retailers and wholesalers probably should have had as much weight as the question of whether the commodities had the same descriptive properties.[3]

TRADE-MARKS AND TRADE NAMES—*Changes Resulting in Resemblance to Another Trade-Mark Improper—(Commentary).* A manufacturer which had by use established legal rights to a trade-mark for tobacco products changed that trade-mark so that it had some resemblance to the trade-mark of a company manufacturing foods. In a suit which the latter company brought to enjoin the tobacco manufacturer from further use of the trade-mark, the court held the defendant to have been within its legal rights in modernizing its label. The commentator agrees that the defendant had a right to modernize its label but denies its right to have incorporated in its label features similar to those of the plaintiff's well-known trade-mark.[3]

(1915–1924)

In June, 1915, the Beech-Nut Packing Company, which manufactured a wide variety of food products, requested the P. Lorillard Company, a manufacturer of tobacco products, to discontinue such use as it was making of the name Beech-Nut in connection with its merchandise. The P. Lorillard Company refused to comply with this request.

The Beech-Nut Packing Company took no further action in the matter until 1919, when it learned that the P. Lorillard Company planned to market Beech-Nut cigarettes. On June 25, 1919, the Beech-Nut Packing Company filed in the United States Patent Office an application for registration of Beech-Nut as a trade-mark for cigarettes. The P. Lorillard Company filed an opposition to this registration. The opposition was sustained and the registration refused on the ground that the applicant had no business in cigarettes upon which the registration requested could be based. The decision of the office of the Commissioner of Patents, delivered on January 18, 1922, read in part as follows:

FENNING, Assistant Commissioner:

This is an appeal from the decision of the Examiner of Interferences sustaining an opposition filed against the application for registration of "Beech-Nut" for cigarettes filed by the Beech-Nut Packing Company on June 25, 1919.

Under Section 7 of the trade-mark statute we are required to determine the question of the right of registration to the trade-mark.

[3] Headnote by Graduate School of Business Administration.

We are thus met in the beginning of the case with the question of whether applicant has such ownership in the mark as entitles it to registration. It is admitted that applicant has never manufactured cigarettes or other tobacco products. It is admitted that the only cigarettes or tobacco products in which applicant has dealt are 2,060 cigarettes which it purchased from the American Tobacco Company on an invoice dated July 12, 1919. These cigarettes were shipped by the American Tobacco Company in three lots—one to an officer of the company in New York City, another to a member of the firm of applicant's attorneys, of record here, at Chicago, and the third to the New Jersey Tobacco Company, Jersey City, New Jersey. The goods shipped to the New Jersey Tobacco Company had not been ordered, were not accepted, but were returned. There is no evidence that any of the Beech-Nut cigarettes were ordered by the parties to whom they were shipped, nor is there any evidence that they were bought or paid for. It is admitted that aside from this single transaction applicant has never been in the tobacco or cigarette business. I am unable to see that this state of affairs is distinguishable from that condemned as not being sufficient to support a trade-mark registration in *Phillips* v. *Hudnut*, (1920, C. D. 164; 263 Fed. Rep. 643; 273 O. G. 629; 49 App. D. C. 247).

. . . .

Applicant claims that having made this sale of cigarettes it discontinued the business for the time being, awaiting the outcome of the present application for trade-mark registration which it was prepared to make.

. . . .

Applicant seems to argue that inasmuch as it was employing a trade-mark on one class of goods it was free at any time to employ that mark on another class of goods, and that in order to obtain registration in the second class of goods it was not necessary to carry on a business as to the second class of goods. This argument is not supported by any cases that I can find and does not seem sound. A trade-mark right grows only from use in a business, and the use of the mark in one business does not afford sufficient foundation for a registration of the mark for another business. Moreover, applicant did not apply to its cigarettes a label like that used on all its other goods.

In the argument and in the briefs many other interesting questions are urged; but since applicant has no business on which to base its registration the Patent Office has no jurisdiction of its case. . . . .

The decision of the Examiner of Interferences is affirmed, the notice of opposition is sustained, and registration refused.[4]

In May, 1921, before this decision was delivered, the Beech-Nut Packing Company had brought suit against the P. Lorillard

[4] *P. Lorillard Company* v. *Beech-Nut Packing Company,* 297 Official Gazette of the United States Patent Office, p. 799.

Company in the United States District Court of New Jersey to obtain an injunction restraining the plaintiff from further use of the trade-mark "Beech-Nut." The court dismissed the bill of the plaintiff. The court's opinion, which was handed down on May 7, 1924, follows:

LYNCH, District Judge. The plaintiff, a New York corporation engaged in the manufacturing and selling of food products, complains that the defendant, a New Jersey corporation engaged in the manufacturing and selling of tobacco, has damaged the plaintiff's reputation and good-will by wilfully and fraudulently adopting the plaintiff's trade-mark "Beech-Nut" as a label for tobacco products, for and on account of which the plaintiff prays an accounting for past damages and an injunction enjoining the defendant from further use thereof. The defendant, admitting the use complained of on certain brands of chewing tobacco and cigarettes, asserts a legal right thereto and prays a dismissal of plaintiff's bill. The word "Beechnut" or "Beech-Nut" was years ago adopted as a label by the predecessors in business of both parties to this action. A brief history thereof is advisable.

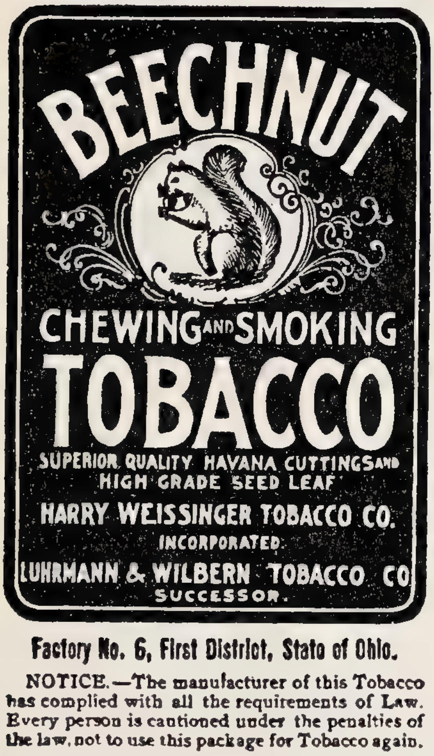

Exhibit 1: Label used by company whose business the P. Lorillard Company later acquired.

About 1897 the Harry Weissinger Tobacco Company, a Kentucky concern, adopted it for a combination smoking and chewing tobacco, which was put up and sold in small packages. The tobacco was described as being of "superior quality Havana cuttings," and was what is known as a scrap tobacco. Herewith is a copy of the label adopted and used by Weissinger (Exhibit 1).

It will be noted that the word "Beechnut" is spelled without a hyphen; that the form of the label, in which not only the word "Beechnut" appears, but a description of the contents and the name of the manufacturer as well, is square, and that immediately underneath the word "Beechnut" is the print of a squirrel. The tobacco so labeled was sold on the market in Kentucky and adjoining states for a number of years subsequent to 1897. The right to make and sell it passed by assignments, stock transfers, and otherwise from the Weissin-

ger Tobacco Company first to the Continental Tobacco Company, next to the Luhrmann & Wilbern Tobacco Company, of Middletown, Ohio, and finally to the American Tobacco Company, where it resided when the latter company was dissolved by the United States Supreme Court during the year 1911. From 1897 to 1911 the tobacco continued to be manufactured, sold, and dealt in by these various companies. For some years prior to 1911, however, the demand for it was gradually lessening; the output reaching a very low ebb in 1911.

The decree dissolving the American Tobacco Company apportioned to the P. Lorillard Company, the defendant, a large number of tobacco trade-marks and brands including *the word* "Beechnut." At that time the sale of "Beechnut" tobacco was practically nil. Up to that time, however, at least, the word had been continuously used as a trade-mark for smoking and chewing tobacco in substantially, if not precisely, the original form adopted by the Weissinger Company back in 1897, although, as we have indicated, the sales had almost completely fallen off. And up to this time (1911) the right to use the word "Beechnut" as a trade-mark in connection with smoking and chewing tobacco does not seem to have been assailed, certainly not by the plaintiff in this suit or by its predecessor in business. That predecessor was the Imperial Packing Company, which in 1892 adopted the word "Beech-Nut" (spelled with a hyphen) as its label for a few food products, such as bacon and ham, which it then manufactured and sold. In about 1899 the Beech-Nut Packing Company was formed, succeeding the Imperial Packing Company. Thereafter the food product business of the plaintiff, growing rapidly, was extended to a variety of products, all relating to food, such as peanut butter, baked beans, chili sauce, tomato catsup, jams, jellies, vinegar, olive oil, ginger ale, mints, chewing gum, etc., in addition to ham and bacon, all of which were labeled "Beech-Nut" and sold as the product of the Beech-Nut Packing Company. An illustration of the plaintiff's label is shown above (Exhibit 2).

Exhibit 2: Label used by the Beech-Nut Packing Company.

It will be observed that this label is oval-shaped; that within the oval are three pictures of beechnuts, one in the centre and one on each side of the oval. Printed across the top will be found the words "Beech-Nut Brand" and across the bottom the name of the particular article which is contained in the package. From the smallest kind of a

beginning in 1891 or 1892 the Imperial Packing Company and its successor, the plaintiff, built up a business which in the year 1919 approximated receipts of $12,000,000.

The Lorillard Company had been in the tobacco business for many, many years prior to 1892, utilizing a great variety of trade-marks and labels in the huge tobacco trade which it had succeeded in establishing. The name of brand or trade-mark "Beechnut" coming to it in 1911 was not at once utilized in the original Weissinger form or otherwise. Nor were any of the 1,000 or more other trade-marks listed on typewritten sheets which the defendant company acquired at the apportionment which we have already referred to. The lists containing all these names or brands were put aside for future reference.

In 1911 the defendant was manufacturing and distributing such well-known cigarettes as "Murad," "Mogul," "Egyptian Deities," "Helmar," "Egyptian Trophies," and the well-known tobaccos "Climax" and "Sensation," besides a large number of other well-known brands. One of these other brands was known as "Honest." There is testimony on behalf of the defendant company that the sales of this "Honest" tobacco had, for a long time, been falling off. We think it is common knowledge that tobacco brands come and go. But, be that as it may, the defendant in or about the fall of 1914 conceived the idea of putting upon the market a new scrap chewing tobacco, a new brand. The formula therefor was worked out, the blend was perfected, and a name was considered. The defendant quite naturally consulted its lists of names or trade-marks which a few years prior thereto had come to it from the dissolved American Tobacco Company. Names on that list which had theretofore been identified with scrap tobacco were, of course, first considered. There were but eight or nine of such names, among which were "Bag Pipe," "Panhandle," "Natural Leaf," and "Scrap Iron." It was discovered that most of these "scrap" names were at the time being used as names for tobaccos then on the market, which fact limited the selection to two or three names. Among the two or three available was "Beechnut." So "Beechnut" was selected and adopted. This new scrap tobacco, which was designed for chewing only, was not, however, put out in the old Weissinger "Beechnut" wrapper. That old wrapper described "Beechnut" as a chewing and smoking tobacco. It had not been manufactured for two or three years, and there does not seem to be anything in the case to justify the conclusion that it had been sold during that period of time. It had just about died out, as tobacco brands often do. And as the new "Beech-Nut" tobacco was of a different character, it was decided by the defendant company to change that old wrapper to one more in accord with the facts and the times. The wrapper decided upon is reproduced on the following page. (Exhibit 3).

It will be observed that, instead of a square label covering almost the entire package, the changed wrapper has what has been termed a sunburst or radiating effect, in the center of which is an oval in shape

somewhat similar to the oval of the plaintiff. Across the top of the oval, inside, the word "Beech-Nut" with a hyphen was placed. Underneath the word "Beech-Nut" the defendant placed the outline of a beechnut *upside down.* Other words placed by the defendant on its label were "Chewing," "Tobacco," "Full Weight," "Extra Picked," and across the top was printed "Lorillard's." The red band oval of the plaintiff was not adopted. Instead the defendant adopted an oval which was quite similar to ovals which were common at the time.

Exhibit 3: One side of a wrapper used by the P. Lorillard Company for chewing tobacco.

This new "Beech-Nut" scrap tobacco, introduced in 1915, within a few years was developed into a business of unbelievable proportions. Selling to the trade at less than the retail price of 10 cents per package, its sales in 1919 amounted to $14,000,000 per year to the manufacturer, approximately $2,000,000 over and above the receipts of the plaintiff for its entire output. Many persons inquired concerning it. Some of them wrote to the plaintiff, the Beech-Nut Packing Company, regarding it, and the plaintiff for a time turned these letters over to the defendant for attention. Then there developed some correspondence between the parties regarding the use by the defendant of this revised or revamped "Beech-Nut" label. This correspondence, which contains a history of the case and the attitude of the parties, is important enough to be set out herein. It follows:

Beech-Nut Packing Company

Canajoharie, N. Y., June 11, 1915.

Lorillard Company, Middletown, Ohio.—Dear Sirs: We adopted many years ago as our trade name the word "Beech-Nut," arbitrarily selected by us as the mark or name for our manufacturing output of food material. We also associated with such trade name "Beech-Nut," and as a part of the trade-mark, an oblong or oval frame or border of a red color surrounding and inclosing a white oblong space with a picture or representation of a beechnut centered therein.

We have built up during the last quarter of a century a vast trade in our products and always with our trade name or trade-mark associated therewith. We have expended a very large sum of money in so doing, and the word or name "Beech-Nut" and our trade-mark has become of vast value to us, not only for these reasons, but for the reason of a high quality and perfection of the various products manufactured by us to which this name and mark has been applied.

So completely has this name and mark been attached to and associated with our goods during all of these years that the purchasing public has come to recognize this name and mark as our property as to origin, and to purchase the manufacture and output to which this name and mark is applied, without any further identification as to the origin of the word or name itself, believing that wherever they see our name and mark applied that we are the manufacturers of the product and purchase accordingly.

We have from time to time added to the variety of our manufacturing commodities to which this name or mark has always been applied, as, for example, a chewing-gum product of somewhat recent production upon our part. While we have never as yet manufactured tobacco, the taking on of such manufacture in the future is by no means impossible or improbable. You will also see that the name or word "Beech-Nut" is a part of our corporate name. We have been thus particular to state this matter to you by reason of the acts upon your part which now follow.

We have been shown a lined bag, evidently employed for packing "Beech-Nut Scrap Tobacco," apparently manufactured by one of your factories at Middletown, Ohio. A prominent feature upon the bag is our trade name "Beech-Nut," including the oval band and our characteristic burrs and nuts. It is difficult to believe that the presence of our trade name "Beech-Nut" and mark upon the bag will not deceive the purchasing public in the belief that the contents of the bag are of our manufacture, and to us there is no other explanation to be given to the presence of our trade name "Beech-Nut" and mark upon the bag, except the intention on your part that the public shall be so deceived, and you will sell your tobacco by reason of the presence thereon of our name and mark. In other words, these acts strongly indicate to us intentional unfair trading.

We have decided in the first instance to write you fully as to this matter and present to you our view of your acts, and to request to you immediately to cease this use of our name and mark and give us written assurance of the same.

We have confidence that, now your attention is called to it, you will recognize the justice of our position and that there will hereafter be no necessity of using any harsher course to enforce recognition of the same. We have been thus particular, also, for the

reason that there can be no contention hereafter that we have not fully stated your position and ours in this matter. An early reply upon your part is requested and expected.

Yours very truly, Beech-Nut Packing Company,
F. E. Barbour

Beech-Nut Packing Company
Canajoharie, N. Y., June 18, 1915

P. Lorillard Company, Middletown, Ohio.—Dear Sirs: Will you kindly advise if we may expect an early reply to our recent communication with reference to the use of the word "Beech-Nut" in connection with your new brand of chewing tobacco?

Yours very truly, Beech-Nut Packing Company,
F. E. Barbour

June 23, 1915

Beech-Nut Packing Company, Canajoharie, N. Y.—Dear Sir: Your letters of June 11 and June 18 addressed to this company at Middletown, Ohio, relative to the use by us of the name "Beech-Nut" for scrap tobacco, have been referred to me.

Preliminary to any discussion of the matter, will you be good enough to let me know when you first began to use the name "Beech-Nut"? I notice on your letter-head "Incorporated 1899," but this, of course, does not necessarily mean that you began to put products on the market under the name "Beech-Nut" at that time.

The statement in your letter of June 11 that you believe we are using the name "Beech-Nut" with the intention that the public shall be deceived into thinking that our product is of your manufacture, is not only without the slightest warrant, but is little short of ridiculous. As a matter of fact, if such an impression should be formed, it would be to our detriment.

Yours very truly,

Beech-Nut Packing Company
Canajoharie, N. Y., July 2, 1915

P. Lorillard Company, 119 West 40th St., New York. Mr. Thomas S. Fuller. Dear Sirs: Your favor of the 23d ult. duly received.

Our "Beech-Nut" trade-mark and trade name has been used by ourselves and our predecessors since and prior to the year 1891. Both our trade-mark and our trade name "Beech-Nut" has been used continuously since that date in our business, and to such an extent and in such manner that both the name and the mark long

since came to have a "secondary significance and meaning"; that is, wherever the mark and name "Beech-Nut" is seen, and no matter with what product it is associated, it has a "secondary significance," and means only the product and products of the Beech-Nut Packing Company.

You are woefully mistaken and entirely misinformed in your assumption, and, indeed, your statement that the public is not deceived by your client's use of our trade-mark and name "Beech-Nut." We know as an absolute truth what is apparent on the face of the facts that the general purchasing public is deceived by your use of our "Beech-Nut" trade-mark and trade name and, indeed, this could not well be otherwise, but we know further that your salesmen and agents deliberately push your goods and trade under this identity of use of their mark and name.

We beg to call your attention in this connection to our former communication to you in this matter and to again urgently request that you immediately stop the use in every way and manner of our trade name and mark "Beech-Nut" in your business without further action upon our part.

Yours very truly, Beech-Nut Packing Company,

F. E. Barbour

Beech-Nut Packing Company, Canajoharie, New York. (Attention F. E. Barbour, Esq.) Gentlemen: We have your letter of July 2d, further with reference to our use of the name "Beech-Nut" on scrap tobacco, and informing us that you and your predecessors have used the name since and prior to the year 1891.

That the name "Beech-Nut" has acquired a secondary significance and meaning in the packing industry and is associated in the public mind with goods of your manufacture may be perfectly true, but this would not give you the right to the name for all purposes. The authorities are overwhelming on this subject. You seem to proceed upon the assumption that we have recently begun to use the name on the tobacco. This is not the case. This company and its predecessor in ownership of this brand have used it continuously since prior to the year 1898, as shown by records in my office. I have not made a search beyond that time, but I have no doubt that I can find that the brand is very much older.

We would not desire to have it thought that our "Beech-Nut" tobacco is made by your company, and if you can give us the name of any salesman of ours who has made such a representation, we would be very glad to have it, and we can assure you that if he did make such a representation, his discharge will immediately follow. It could be of no conceivable advantage to us to have the public think that our tobacco product was manufactured by a

packing establishment. Our concern has been in business for more than one hundred and fifty years, and in that length of time has built an enviable reputation for the excellence of its tobacco products.

Though you may turn out an excellent quality of bacon it does not follow that you could turn out an excellent quality of tobacco, or steel rails or pianos or aeroplanes. If your contention were true, we, who have a brand of tobacco called "Climax," could enjoin the use of the name on a well-known threshing machine which is sold in the Western States, or we could enjoin the use of our name on the Lorillard refrigerators. It has never occurred to us to attempt either.

If you will look at our package of Beech-Nut tobacco, you will see that the name "Lorillard" is prominently displayed thereon. This was done with the desire that people should know the tobacco is coming from the Lorillard Company. It has been our belief that the fact that Lorillard made it would of itself be of value to the brand.

It is difficult to see how you can seriously claim that there is the slightest similarity in the marking of the package and the facsimile of your mark as displayed on your letter-head.

If you desire me to point out to you authorities which I consider completely sustain my view as expressed herein, I will take pleasure in doing so.

Yours very truly,

Beech-Nut Packing Company

Canajoharie, N. Y., July 26, 1915

P. Lorillard Company, 119 West 40th St., New York. Thomas S. Fuller. Dear Sirs: Please pardon the delay in acknowledging receipt of your favor of July 8.

We will greatly appreciate it if you will send us samples of your product showing the manner of use of the word "Beech-Nut" since the year 1898, copies of advertisements or of letter-heads showing your use of this name. We trust you will consider this a fair request, as we would like to reach a prompt and friendly termination of the correspondence on this subject.

We also desire to take advantage of the offer contained in the last paragraph of your letter to point out to us the authorities which sustain your views.

Thanking you in advance for the information requested herein, we remain

Yours very truly, Beech-Nut Packing Company,

F. E. Barbour

Beech-Nut Packing Company
Canajoharie, N. Y., September 2, 1915

Mr. Thos. S. Fuller, 119 W. 40th St., New York—Dear Sir: Kindly refer to your favor of July 29, in which you advised that you would collect the information requested in our letter of July 26 after your return from a week's absence. Up to the present we do not seem to have heard from you and will greatly appreciate the information requested.

In this connection, we received today an inquiry from New River Gro. Co., Hinton, West Virginia, asking the best jobbing price on Beech-Nut scrap tobacco, from which you will note that in the minds of some, at least, Beech-Nut scrap tobacco is credited to the Beech-Nut Packing Company.

Thanking you to favor us at your early convenience, we remain,

Yours very truly, Beech-Nut Packing Company,
F. E. BARBOUR

September 15, 1915

F. E. Barbour, Esq., Beech-Nut Packing Company, Canajoharie, N. Y. Dear Sir: I have been able to locate some old price-lists which contain our Beech-Nut scrap tobacco, and inclose them herein. I am also sending you an old package showing the use of the name "Beech-Nut" and our present package.

Beech-Nut chewing and smoking tobacco (scrap) was made by Harry Weissinger Tobacco Company, of Louisville, Kentucky. This company was bought out by the American Tobacco Company some time in 1903. Prior to the acquisition of the Weissinger Tobacco Company by the American Tobacco Company, the Luhrmann & Wilbern Tobacco Company, of Middletown, Ohio, was acquired by the Continental Tobacco Company. In 1904 the American Tobacco Company and the Continental Tobacco Company were merged into a new company formed for that purpose and known as The American Tobacco Company.

Under the decree of the Circuit Court of the United States for the Southern District of New York, the so-called tobacco combination, which included the American Tobacco Company, was split up. In this disintegration proceeding the Luhrman & Wilbern Tobacco Company, which had always been maintained as a separate entity, was acquired by P. Lorillard Company. In the meantime some of the brands formerly manufactured by the Weissinger Tobacco Company had been taken over and manufactured in the Luhrmann & Wilbern factory in Middletown, and after the acquisition by our company of the Luhrmann & Wilbern business, including these brands, we continued to operate it as a separate company until about two years ago, when we dissolved

it, taking over all of the business and brands directly in our own name.

I give you this history, so that you may understand the various price-lists in the name of Luhrmann & Wilbern Tobacco Company and the package in the name of Harry Weissinger Tobacco Company. I do not know the exact date of the old package, as the stamp is not legible, but it was prior to 1903.

The price-lists that I send you are dated January 2, 1904, May 6, 1907, July 1, 1910, and November 3, 1910.

It is difficult for me to see how any one can claim that there is any similarity in our products and yours or in your label and ours, other than the name "Beech-Nut." Your claim that we would not have the right to use the name "Beech-Nut" on tobacco products must find its basis in the idea that you can appropriate the name "Beech-Nut" for all products of whatever character.

That the law does not permit of such a claim is elementary. If your claim were maintainable, then the Lion Brewery in New York could enjoin the manufacture of Lion brand collars, or vice versa. Suppose that the J. B. Williams Company should tomorrow put out a new brand of shaving soap called "Beech-Nut." Do you argue that you could stop it because you have first used the name on ham and bacon? It seems to me that your argument must lead to this conclusion. The law of unfair competition, so far as it assumes to protect the public, assumes to protect the purchaser of average intelligence. It is difficult to believe that a person of average intelligence who enters a store for the purpose of buying "Beech-Nut" hams or bacon could be deceived into thinking he was getting either if he were handed a package of "Beech-Nut" chewing tobacco, or that the "Beech-Nut" chewing tobacco was manufactured by the manufacturer of the hams and bacon. It is no more the custom in this country for a packer to manufacture chewing tobacco than it is for a manufacturer of beer to manufacture collars, and the purchaser of average intelligence perfectly well knows this.

We have tried to make it evident on our package that our "Beech-Nut" chewing tobacco is of our manufacture, by stamping across the top of the package, before the name "Beech-Nut" "Lorillard's." We have also on the other side of the package, plainly printed, that it is manufactured at Middletown, Ohio. There is nothing in the get-up of the label, whether in design, color, or wording, which could suggest to a person of average intelligence that it was of your manufacture, or in fact the manufacture of any one except the Lorillard Company.

As I have written you before, we consider it of immense value to the brand itself that it is manufactured by the Lorillard Com-

pany, and we desire the consumers of tobacco to know this, because we believe that the Lorillard name carries with it a vast amount of good-will and a guaranty of excellence. We are justified in this belief by reason of the immense increase in the sales of "Beech-Nut" scrap since we took the former manufacturer's name off and put "Lorillard's" thereon.

I think this covers the situation, except with respect to any representations which you claim that some of our salesmen made, to the effect that our "Beech-Nut" scrap was a product of your company. I have written you before that if you will give me the name of any salesman who has made such representation, and that fact can be determined, his discharge will be immediately forthcoming, as he can be of no service to us. If you will point out to me anything in the conduct of our business which tends to create a belief in the trade that our "Beech-Nut" scrap is made by you, we will thank you, so that we may rectify it. I assure you that we are just as anxious as you are, if not more so, to prevent any impression that our tobacco is made by you. Will you let me have a copy of the letter you received from the merchant in West Virginia making inquiry of you for "Beech-Nut" tobacco?

On this general subject, if you have not already done so, you might consult Nims on "Unfair Business Competition," pages 200 to 300. Therein I think you will find a very complete and satisfactory discussion of the law governing this subject. I will quote you paragraph 117 on page 236:

"Property in a place name for all purposes cannot exist in one person, under ordinary circumstances. The defendant must be using it in the same or a similar business as the plaintiff. Large amounts of rubber as well as licorice might be found in Anatolia. If there were, the rights which the complainant has acquired in the use of the name in the licorice business would not prevent another under certain conditions from acquiring a sole right to use the name in the rubber trade."

There is no distinction so far as the principle here laid down is concerned between a place name, a generic name, or a fanciful name. You might also consult the cases of *Borden's Ice Cream Company* v. *Borden's Condensed Milk Company*, 201 Fed. 510, and *Wells* v. *Ceylon Perfume Company*, 105 Fed. 621.

I apologize for the length of this letter. I desire to give you the facts fully, together with our views, and I sincerely hope that this will satisfy you as to the law and our entire good faith. We are as proud of our good-will and the excellence of our products in the tobacco business as you are of yours in the packing industry, and we believe with good reason.

Yours very truly, (Signed) THOS. S. FULLER

Beech-Nut Packing Company
Canajoharie, N. Y., September 20, 1915

Mr. Thos. S. Fuller, 119 West 40th St., New York—Dear Sir: We have your very interesting letter of Sept. 15, together with the price-lists referred to and the package of tobacco.

Your letter is a very interesting one, and, before giving a definite reply to same, desire to review the matter as presented by you, so that we can give you an intelligent reply.

At this time, however, we may express our agreement with you that the name Lorillard carries with it a vast amount of good-will and unquestionably a guaranty of excellence. So does the name "Beech-Nut Packing Company," and we take the view that the increase in sales of Beech-Nut scrap tobacco is due to the exploitation of the name "Beech-Nut" with the oval label, and we cannot help but assume that the general impression is that these goods are manufactured by this company rather than by Lorillard, at least to a considerable degree, for since writing you last we have another inquiry, and this time from Wm. Edwards Company, of Cleveland, Ohio, asking us to ship them five cases of Beech-Nut scrap tobacco. The previous inquiry came from New River Grocery Co., Hinton, West Virginia.

Yours very truly, Beech-Nut Packing Company,
F. E. Barbour

After this correspondence terminated in 1915, no action of any character was taken by the plaintiff as against the defendant. For four years thereafter there was inactivity on the part of the plaintiff, during all of which time the defendant continued to deal in this "Beech-Nut" scrap chewing tobacco on a very large scale.

In 1919 the Lorillard Company planned to put on the market a "Beech-Nut" cigarette and again there ensued some correspondence between the parties relative to this. . . . . Negotiations between the parties relative to the right of the defendant to use "Beech-Nut" as a label for cigarettes terminated without result. Thereafter the Beech-Nut Packing Company decided to apply for registration of "Beech-Nut" for cigarettes, which application was published in the Patent Office Gazette, and the Lorillard Company, upon learning of it, filed a notice of opposition in the Patent Office where a hearing was had. The proceedings, a copy of which is by stipulation a part of this case, resulted in the denial of the plaintiff's application, from which the plaintiff did not appeal.

In May, 1921, the plaintiff instituted its present cause of action, alleging that the defendant has injured its business good-will—has appropriated the good-will of the plaintiff for its own uses. One of the defenses interposed is that of estoppel; the following extract from the

opinion of Judge Mayer in the case *Valvoline Oil Co.* v. *Havoline Oil Co.,* D. C. 211 Fed. 189, being called to our attention:

> It cannot be equitable for a well-informed merchant, with a knowledge of a claimed invasion of right, to wait to see how successful his competitor will be, and then destroy with the aid of a court decree much that the competitor has striven for and accomplished—especially in a case where the most that can be said is that the trade-mark infringement is a genuinely debatable question.

To the point of estoppel the plaintiff replies that the testimony taken in the Patent Office proceedings *first revealed* to it that the defendant had abandoned the "Beechnut" label or trade-mark which was acquired in 1911; that it, from 1915 on, relied on the representation of the defendant as to facts, which were peculiarly within the knowledge of the defendant and inaccessible to it, which upon their face (as furnished by the defendant) gave the defendant the indefeasible right to go on with the "Beech-Nut" scrap tobacco; that the Patent Office proceedings disclosed that there was no continuous use of "Beech-Nut" as a label for tobacco, as the defendant had stated to it in 1915, but that the label "Beechnut" so allotted in 1911 had been abandoned, and that some years thereafter a new trade-mark containing the word "Beech-Nut" was adopted; the facts showing that there was a clear intention on the part of the defendant to abandon the old "Beechnut" label, and to substitute for it one similar to that used by the plaintiff.

Did the defendant abandon "Beechnut" as a label for tobacco by permitting the word to lie dormant for three or four years, and then reviving it in the manner which has already been described? In considering this question it should be constantly kept in mind that the right to use a word for trade-mark purposes is usually, if not always, confined to "merchandise of the same descriptive properties." The limitation of the scope of trade-marks "to merchandise of the same descriptive properties" (Sec. 5 (*b*), Trade Mark Act February 20, 1905) was adopted in the statute as an expression of the scope designated in the decisions of the court under the common law (*Hanover Star Milling Co.* v. *Metcalf,* 240 U. S. 403, 412-14), and the classification of the Patent Office, by which "tobacco Products" were placed in Class 17 by themselves, is an expression of legal scope by an authority which raises a presumption. Likewise, the placing of "foods and ingredients of foods" in a class by themselves, No. 46, raises a presumption that the scope of trade-marks adopted for foods and ingredients of foods is not to extend over other classes. If any cases are to be found which seem to depart from this rule, examination will show either that they involved facts showing actual fraud or bad faith or the equivalent thereof (*Peninsular Chem. Co.* v. *Levinson,* 247 Fed. 658), or that the two articles of merchandise are habitually used in conjunction, as was the case of the flour and syrup in *Aunt Jemima Co.* v. *Rigney Co.,* 247 Fed. 407, of steam apparatus and steam traps to be used therewith in

Simplex v. *Gold,* 43 App. D. C. 281, of electric lamps and incandescent mantles in *Anglo-American Co.* v. *General Co.*, 43 App. D. C. 385, and of automobile tires and automobiles in *Akron-Overland Tire Co.* v. *Willys-Overland Co.*, 273 Fed. 674.

. . . .

As we shall see, the fundamental doctrine in this country, as declared by the Supreme Court of the United States in the Hanover Star Milling Company cases (240 U. S. 403, 412-414) and reiterated by that court in the Rectanus case (248 U. S. 90, 97), is that there is no such thing as property in a trade-mark except as a right appurtenant to the established business or trade in connection with which the mark has been applied so that a trader has no property in the mark per se, but only in reference to his trade, and cannot prevent another trade from applying this mark to goods which are not of the same description.

Indeed, the books are full of cases illustrating and applying the well-settled doctrine that in this country the same mark may be used by different concerns for different articles, notwithstanding these articles are packaged and sold in the same stores.

. . . .

Many instances of the use by one concern of a word as a trade-mark for tobacco and the use by a different concern of the same word as a trade-mark for products of a different character have been called to our attention.

There are "Mogul" cigarettes and there are "Mogul" food products, such as evaporated milk, tapioca, sugar, red pepper, almond flavor, and peppermint.

There are "Camel" cigarettes and there are "Camel" food products, such as canned corn, tomato catsup, rolled oats, oysters, ginger, and sweet pickles.

There are "Omar" cigarettes and there are "Omar" food products, such as vanilla, plums, wax beans, sauerkraut, and coffee.

There is "Star" tobacco and there are "Star" soap and washing fluid.

There are "Sunshine" cigarettes and there are "Sunshine" biscuits.

There are "Polo" cigarettes and there are "Polo" canned goods.

There is "Climax" tobacco and there are "Climax" chocolate dates.

There is "Apple" tobacco and there is "Apple" chewing gum.

It will thus be observed that the distinction between tobacco and food products has for a long time been quite generally recognized.

Next we shall refer to the law of "abandonment."

In *Baglin* v. *Cusenier Co.,* 221 U. S. at pp. 597-8, the court said:

> But the loss of the right of property in trade-marks upon the ground of abandonment is not to be viewed as a penalty either for non-user or for the creation and use of new devices. There must be found an *intent* to abandon, or the property is not lost.

. . . .

In *Saxlehner* v. *Eisner*, 179 U. S. 31, 21 Sup. Ct. 11, 45 L. Ed. 60, the court says:

> To establish the defenses of abandonment it is necessary to show not only acts indicating a practical abandonment, but an actual intent to abandon. Acts which unexplained would be sufficient to establish an abandonment may be answered by showing that there never was an intention to give up and relinquish the right claimed.

In Browne on Trade-Marks, Sec. 681, it is said:

> A person may temporarily lay aside his mark and resume it without having in the meantime lost his property in the right of user. Abandonment being in the nature of a forfeiture, must be strictly proved. . . . . A defense of abandonment is abhorrent even in an action at law, and the assertion of title on the ground of abandonment by the prior owner must be established by the strongest proof. Mere lapse of time does not per se warrant the conclusion of abandonment. The circumstances of the case, other than mere lapse of time, almost always give complexion to the delay and either excuse or give it a conclusive effect.

And in Hopkins on Trade-Marks (3rd Ed.) p. 213, appears the following:

> The length of time during which a trade-mark is not used is, as we have seen, merely a circumstance to be considered with all the other facts in the case in determining whether there was an intention to abandon its use. Thus defendants have been restrained from using a mark that has lain in disuse for periods of one year, three years, four years, nine years, ten years, and even twenty years. The vital question is the intention of the owner of the mark, and the burden of establishing abandonment lies upon the party who affirms it.

In a comparatively recent case of *Wallace & Co.* v. *Repetti*, 266 Fed. 307, the Circuit Court of Appeals for the 2nd Circuit, speaking through Judge Manton, said:

> In order that an abandonment may be established as a defence, it is essential to show, not only acts indicating practical abandonment, but an intent to abandon. Thus, where the appearances may be sufficient to indicate an abandonment, this may be satisfactorily explained by showing a want of intention to relinquish the right claimed. *Saxlehner* v. *Eisner & Mendelson Co.*, 179 U. S. 19, 21 Sup. Ct. 45 L. Ed. 60. There is no penalty which inflicts the loss of right of property in trade-marks by nonusage, unless there also be found an intent to abandon (p. 308).

. . . .

When the defendant received the list containing these trade-marks,

including "Beechnut," in December, 1911, it filed that list with its records. There is undisputed testimony in the case that trade-mark names are valuable—have unlimited values—and so far as appears the only tangible thing received by the defendant at the time was the list of words, including "Beechnut." That list was not destroyed, but was put away, where it was consulted from time to time.

On three different occasions, at least, the defendant took from this list names for use as labels for tobacco products, to wit: "Comet," "Pioneer," and "Yacht Club." Reviewing the conduct of the defendant, one must conclude, it seems, that it intended to retain all of these listed names, and avail itself of them from time to time as the situation of its business suggested. For three years there was no act on the part of the defendant which would tend to indicate in the slightest degree that the word "Beechnut" had been or was to be abandoned. When it is remembered that there were a thousand or more names on the list, the mere nonusage of one word for that period would not in itself amount to abandonment. So we find that in the fall of 1914 there had been no abandonment of "Beechnut" on the part of the defendant.

The other aspect of the question is whether, in reviving the use of "Beechnut" as a label for its tobacco products, there was effected an abandonment because the defendant in 1914 changed both the Weissinger formula and the old label in favor of a new kind of tobacco and a different label.

Change of formula has never indicated abandonment. The contrary is the ruling of the courts. In *Royal Milling Co.* v. *J. F. Imbs Milling Co.*, 44 App. D. C. 207, the Court of Appeals for the District of Columbia says:

> The trade-mark is not to be vitiated by change in the species of wheat used, any more than it would be vitiated by an important change in the process of making flour.

. . . .

The defendant, acquiring the right to use the word "Beechnut" for tobacco purposes, found that the particular formula of tobacco which had been sold for both smoking and chewing purposes by the predecessors who controlled the trade-mark was practically dead. The defendant, under the circumstances, certainly had the right to endeavor to revive this old tobacco, if it could, and it seems to the court that it also had the right to improve it, if it could—improve the tobacco in any way which would make it marketable. Tobacco is tobacco; but there are many, many blends, mixtures, etc. Adopting a new formula, therefore, did not, in the opinion of the court, work an abandonment.

Next, as to the right of the defendant to change the label:

In the case of *United Barbers' Service Co.* v. *Canalaito,* 12 Trade-Mark Rep. 265, a case before the Commissioner of Patents for cancelation of a registered trade-mark, "X-Ray," it appeared that the owner and registrant had proved use of the mark since 1914, while the plaintiff

or petitioner proved use since 1915. The commissioner dismissed the petition, holding:

> The fact that the first labels were in manuscript and printed labels were used only from 1918, does not matter, as the use was continuous.
>
> Nor does the fact that the printed labels used in 1918 first showed the picture of a woman, though use was claimed since 1913, ... , as the word "X-Ray" is the essential feature of the mark.

There is nothing in the record to indicate that the old Weissinger squirrel label was attractive to any purchaser, either because of its color or design. Whatever sales were effected do not appear to have been effected because of the label. Although it carried the picture of a squirrel, the tobacco was always referred to, so far as we are aware, as "Beechnut," and not otherwise. There does not appear to be any particular reason why a squirrel should appear under the word "Beechnut" rather than the picture of a beechnut. The old formula was not to be dealt in any longer, and it seems to us that the change in the formula justified a change in the decorative features of the package which was to contain this new blend or mixture. So the label was modernized, made attractive. Is it not common knowledge that many old standard tobaccos are now ornamented considerably differently than they were years ago? Boxes, containers, and packages for tobacco have undergone many improvements during the past twenty years. To hold that the rightful owner of an established trade name may not redecorate or reornament, or, to use a somewhat inelegant phrase, polish it up, would be, in our opinion, unreasonable. So the defendant, availing itself of the right to redecorate and reornament its label, adopted as the main change, as a comparison will promptly disclose, what has been called a sunburst or radiating effect. Nothing like this sunburst or radiating effect appears on the labels of the plaintiff, and the fact that the defendant adopted it demonstrates conclusively, it seems, that there was no attempt on the part of the defendant to copy or imitate the standard mark of the plaintiff. Not only was there a sunburst or radiating effect placed upon this new label, which, by the way, overshadows most of the other features of it, but, instead of there being three colored photographs of a beechnut, the defendant placed the red outline of one in an inverted position. The plaintiff argues that the two trade-marks are so similar that the public thinks that they are the same. If one should eliminate the word "Beech-Nut" from both labels, it would be extremely difficult to locate any similarity at all between them. And each party has the right to the word "Beech-Nut" for its distinct product. It may be that what the defendant did in changing the old Weissinger label has amounted to an abandonment of the squirrel and other decorative features of the old label, which have been omitted from the revised label; but the court is unable to agree that

the word "Beech-Nut" was abandoned simply because a hyphen was utilized in addition to the adoption of different decorative features, the main feature of which is a sunburst or radiating effect, unknown to any label of the plaintiff which has been called to our attention.

What we have said relative to the defendant's right to use the word "Beech-Nut" in connection with tobacco applies also to the cigarette feature of this case. Cigarettes contain tobacco and are smoked. The trade-mark acquired by the defendant was for smoking and chewing tobacco and, as we have already pointed out, it is our opinion that the blend, or formulas, could be changed, and the labels could be redecorated, without effecting an abandonment of the word.

There being no abandonment on the part of the defendant, the bill should be dismissed.

COMMENTARY: This case presents a conflict of interests of the type which seems to be almost inevitable when businesses are expanding and merchandising methods are changing. The P. Lorillard Company had an unquestioned right to its original "Beechnut" trade-mark for tobacco, dating back to 1897. Cigarettes are so closely related to other tobacco products from the manufacturing and sales points of view that the application of a trade-mark used on chewing tobacco to cigarettes was a natural commercial development. The Beech-Nut Packing Company's predecessor began utilizing its "Beech-Nut" trade-mark in 1892 on food products. In 1897 the predecessor of the Beech-Nut Packing Company was using its mark only on food products. For that reason, and also because of the strong contrasts in appearance of the two marks at that time, the predecessor of the Beech-Nut Packing Company would not have been entitled to enjoin the use of the mark adopted for tobacco by the predecessor of the P. Lorillard Company. Each company, therefore, properly acquired rights in its mark. The subsequent changes in the form of its mark by the P. Lorillard Company and the development of the business of the two companies brought their interests into conflict.

In the decision of the court the endorsement of the course pursued by the P. Lorillard Company in changing the form of its mark in 1915 was not warranted. The P. Lorillard Company had the right, of course, to modernize its trade-mark without invalidating it. In modernizing the trade-mark, however, it was incumbent on the company to make its revised mark so distinctive that it would not intrude upon the rights of any other trade-mark owner. This was not done. Whereas many other forms of pictorial arrangement of a modern tone might have been selected, the one chosen used the hyphenated spelling and an oval design similar to the well-known mark of the Beech-Nut Packing Company. The inquiries received by the Beech-Nut Packing Company

showed that confusion did arise in the minds of merchants, and hence, it may be assumed, among consumers, as to the commercial origin of the tobacco bearing the "Beech-Nut" trade-mark. In modernizing its mark, it was the duty of the Lorillard Company to avoid any similarity whatsoever, aside from the word "Beechnut," in the form of pictorial illustration, for the company hardly could have failed to be acquainted with the mark of the Beech-Nut Packing Company.

The reasoning in the court's decision regarding the dissimilarity in the two types of merchandise to which the trade-marks in controversy were applied is not convincing. In trade-mark law the doctrine is firmly established that the right to the use of a word for trade-mark purposes usually is confined to "merchandise of the same descriptive properties." There is little likelihood that the word "Lion" used as a trade-mark for both beverages and collars will cause confusion regarding the commercial origin of the two classes of commodities bearing that mark. There is a limitation on this doctrine, however, which was not recognized in this case. The development of so-called "family" or "blanket" trade-marks necessitates a modification of the doctrine. For example, Armour & Company has applied its Oval Label trade-mark to a variety of products, all of which do not have the same descriptive properties. The "Winchester" trade-mark is applied to sport clothing as well as to cutlery and firearms. Surely there is as great a difference between sport clothing and cutlery as between chewing gum and cigarettes; and presumably there is as great difference between chewing gum and bacon as between chewing gum and chewing tobacco.

The Beech-Nut Packing Company by applying its trade-mark to mints and chewing gum apparently was developing a blanket trade-mark. Since cigarettes, chewing gum, and mints frequently are sold in the same stores, it does not require a stretch of the imagination to conceive that the company might have contemplated including cigarettes within the group of commodities to which its mark was applied. Tobacco is sold in large quantities by retail and wholesale grocers. Even though the Beech-Nut Packing Company would not have been entitled to use the word Beech-Nut on any tobacco product, because of the rights to the use of that word acquired in good faith prior to 1915 by the P. Lorillard Company, the growth in the use of "family" trade-marks was a strong reason why consumers might have been misled by the P. Lorillard Company's trade-mark on tobacco, and especially on cigarettes. When one party to such a controversy is developing a "family" trade-mark, the rights to that mark should not rigidly be restricted to merchandise of the same general properties; the question of whether two commodities are sold by the same classes of retail and wholesale merchants should be given as much weight,

probably, as the similarities in the character of the merchandise itself. Hence the court should have protected the Beech-Nut Packing Company in this case, not by permitting it to use its trade-mark on cigarettes, which would have invaded rights established by the P. Lorillard Company, but by insisting that, in modernizing its trade-mark, the P. Lorillard Company should have refrained from the use of the oval design and the hyphenated spelling which were characteristic of the Beech-Nut Packing Company's trade-mark.

In this case the significance of the broadening use of "family" trade-marks apparently was not brought forcefully to the attention of the court.

The Beech-Nut Packing Company prejudiced its case against the P. Lorillard Company by its abortive attempt to establish a right to register its trade-mark for cigarettes by transactions which were not of a bona fide commercial character. Reliance on the "family" trade-mark development would have been a much sounder course to have followed in preventing the use of a somewhat similar mark by the P. Lorillard Company.

This case shows that the old doctrine that the right to the use of a word for trade-mark purposes is confined to merchandise of the same descriptive properties should be interpreted liberally in view of the development of numerous "family" trade-marks for merchandising purposes.

January, 1926 M. T. C.

Southerly Company[1]

MANUFACTURER—MARKING TAGS

Brands—*Manufacture of Goods to Bear Wholesalers' Private Brands.* The company, which produced a wide variety of high-grade paper products, placed its own name on all the marking tags which it manufactured. It refused orders for tags from wholesalers who stipulated that their own names or the names of their customers should replace the manufacturer's name on the tags. Although the company estimated that it could produce a temporary increase of at least 10% in its sales of tags by accepting such orders, it refused them because it believed that, by providing wholesalers with high-grade, privately branded tags to be sold in competition with tags bearing its own brand, it eventually would decrease its sales of tags.

(1923)

In 1923 the total sales of the Southerly Company, which produced a wide variety of paper articles, were $9,000,000. Approximately 12% of that amount represented sales of plain marking tags, all of which were manufactured for stock. The company's name appeared on the reinforcing labels of all its tags. Numerous wholesalers had requested the company to supply them with tags on which their own names or the names of their customers appeared in place of the manufacturer's name, but, so far, the company had refused all such orders.

The Southerly Company had obtained national distribution for its products under its own trade name and by means of its own salesmen. It always had maintained a high standard of quality in factory production, and quality and reliability were its chief selling arguments; its prices were slightly higher than those of competitors. The company sold to wholesalers and also directly to retailers and industrial users, all of whom it offered the same quantity discounts; the company offered no trade discounts. Its terms were 30 days net. The company did not attempt to control the resale prices of its products.

With the exception of marking tags, the company produced all its classes of merchandise both for stock and upon special orders. Approximately 60% of its total sales were of special

[1] Fictitious name.

articles and about 40% were of stock articles. Because of strong competition in the sale of tags, the company's gross margin on tags was smaller than its gross margin on items manufactured upon special orders.

The company's machinery for the manufacture of marking tags frequently operated at but from 60% to 75% of capacity because of lack of orders. The company estimated that it could increase its sales of tags at least 10% by accepting orders from wholesalers who stipulated that their own names or the names of their customers should replace the company's name on the tags. The acceptance of those conditional orders would permit the company to operate its equipment more regularly and to produce tags more economically. If the Southerly Company refused the orders, they would be given to its competitors. The wholesalers were unwilling to have both their own names and the name of the Southerly Company on the tags.

Because the Southerly Company had established a reputation for the excellent quality of its products, the executives of the company wished the company's name always to be associated with its products. The executives were of the opinion that, if the public found wholesalers' brands of tags equal in quality to the Southerly tags, the selling advantage of the latter would be weakened. It was possible, moreover, that a wholesaler, after having established his brand on the basis of Southerly quality, would purchase tags of a lower grade from competitors of the Southerly Company and undersell that company. Although the executives recognized the desirability of increased orders for tags, they were of the opinion that acceptance of the conditional orders eventually might reduce sales, as well as weaken the competitive position of tags bearing the company's name. They decided, consequently, to continue to refuse orders for tags on which another firm's name was to appear.

COMMENTARY: The decision of the company to refrain from accepting orders which were to bear the names of wholesalers or their customers was sound. The mere placing of the private brands on the tags would not have increased the aggregate quantity of tags used. In so far as individual retailers and wholesalers stimulated sales for their private brands they would have cut into the market for other brands, including Southerly tags. To the extent that such private brands as

were produced by the Southerly Company obtained a share of the sales previously made by other manufacturers, the Southerly Company would have gained. That gain, however, would have been of doubtful permanence.

Had the Southerly Company filled orders for private-brand tags, it would have aided the owners of those brands in securing a foothold in the market with tags of good quality. Once in the market the private-brand owners could have purchased from other sources, if they so desired, perhaps lowering quality in order to be able to underquote competitors. Thus the volume of sales of the Southerly Company might have been endangered; at best the company could not fairly have expected any net gain, except temporarily, from engaging in the manufacture of private brands. Inasmuch as the Southerly Company was in a strong financial position, with a well-established reputation for its brand, it could afford to act independently, by refusing to accept private-brand orders.

March, 1926 **M. T. C.**

Hutchinson Department Store[1]

DEPARTMENT STORE—PAPER BOXES

Purchasing—*Maintenance of Relations with Several Sources to Safeguard Supply.* In order to protect itself against the possible inability of its customary supplier to meet its requirements of paper boxes, a department store decided to divide its purchases between its customary supplier and another company even though the latter quoted higher prices and gave less satisfactory delivery service than did its competitor.

(1921)

Prior to 1920, the Hutchinson Department Store had purchased its entire supply of folding paper boxes from the Rivett Company.[1] Both companies were located in the same city. The department store's average annual purchases of paper boxes amounted to about $50,000. The purchasing agent made contracts for a year's supply at the beginning of each year, and the manufacturer made deliveries according to the purchaser's requirements. Each year the purchasing agent requested bids from several manufacturers of paper boxes. The quotations of the Rivett Company always had been equal to or lower than those of its competitors.

In 1920, because of a fire at the Rivett Company's plant, that company could not fulfil its contract with the Hutchinson Department Store, and the purchasing agent of the store had difficulty in obtaining containers to meet his requirements. Other paper box manufacturers were unable to give prompt delivery and frequently could not ship the boxes when promised because of the heavy demand and the difficulty of securing sufficient quantities of raw material. The purchasing agent of the Hutchinson Department Store believed that if the store formerly had made purchases from more than one paper box manufacturer, it would not have had difficulty in obtaining a sufficient supply during the emergency. Accordingly, when the Rivett Company resumed operations, the purchasing agent weighed the advisability of dividing his purchases between that company and another paper box manufacturer.

[1] Fictitious name.

The most important factors influencing the purchasing agent in selecting sources of supplies were price, quality, and promptness and punctuality of delivery. He also took into consideration the reliability of a manufacturer and his reputation for exact fulfilment of specifications. In placing orders, the purchasing agent usually favored manufacturers who had given satisfactory service over a period of years.

The purchasing agent was not certain that the purchasing of paper boxes from more than one manufacturer would be advantageous. The Rivett Company had established a reputation for quality and for exact fulfilment of specifications. The company was careful to prevent mistakes in shipping, invoicing, and checking the quantity and quality of its products. Because of its location the Rivett Company was prepared to deliver on short notice.

The purchasing agent concluded that, of the Rivett Company's competitors, the Emerson Company[2] was the most satisfactory so far as price, quality, delivery, and reliability were concerned. The Emerson Company, however, was located 200 miles from the Hutchinson Department Store, and the purchasing agent expected that if he bought from that source he would have to place orders for shipments on contracts about a month earlier than he would if he continued to purchase from the Rivett Company.

The quality of the Emerson Company's boxes was as high as that of the Rivett Company's products. The Emerson Company's quoted prices were on the average about 25 cents per thousand higher than those of the Rivett Company. It was possible, however, that division of purchases between the two manufacturers would result in a competitive lowering of the prices of both. Such a division of purchases, moreover, would assure the purchasing agent that two manufacturing companies had immediate interest in supplying the Hutchinson Department Store. If unforeseen circumstances prevented one box company from fulfilling its contract, the purchasing agent could depend on the other to meet the store's requirements.

In 1921 the Hutchinson Department Store decided to order one-half of the boxes which it needed from the Rivett Company and the other half from the Emerson Company. This division of purchases increased the cost of folding paper boxes to the com-

[2] Fictitious name.

pany. In addition, the purchasing agent had to order half of the store's requirements further in advance of actual needs than he previously had done. The store, however, was convinced that it was in a safer position than formerly.

COMMENTARY: An unusual coincidence precipitated this department store's problem as to whether to purchase such operating supplies as paper boxes from more than one source. The company from which the store previously had purchased boxes suffered an interruption of production because of fire during the boom period in 1920. The occurrence of a fire in the plant of a producer of supplies at the height of a boom period is not a risk which in itself should govern the general policy in such a case as this. The problem which was precipitated under such unusual circumstances, however, might have been precipitated by other circumstances more likely to recur.

In deciding whether this store should have divided the purchases of paper boxes between two or more sources, it is to be noted that the cost from the second source was higher. This obviously was a reason against dividing the orders. Reference is made to the disadvantage in having to place the orders with the second source a month earlier than with the first source. This is a secondary matter, however, because it merely requires routine attention. The service of the old source in inspecting, shipping, and invoicing the supplies was a matter of consequence, however, because of the effect that service had in lightening the burden of the department store and in avoiding irritating adjustments.

Despite these adverse factors, the decision of the company in this instance was sound. A continuous supply of these boxes was required; it was necessary that deliveries should be made continually in order to avoid interference with the major operations of the business, and supplies of the type of paper boxes required so much storage space that, as a general policy, the department store could not undertake to carry a stock to protect it in the event of emergencies. Storage space in an urban district usually is expensive, and if the company were to adopt the policy of carrying a reserve stock to protect itself against emergencies, that policy should apply not only to paper boxes but also to many other supplies that the store buys. The general application of such a policy would involve an unwarranted expense. The expense of such a policy, in fact, probably would more than offset the extra cost of supplies which would result from a division of the orders.

It is quite possible that in an emergency the second source might already have obligations to other customers which would prevent its furnishing the company with a greater quantity of supplies than the

contract called for. That quantity, however, would take care of the most urgent requirements of the company and there was the further value of an established relationship which would assure friendly consideration of the purchaser's requests in an emergency by a source that was familiar with the purchaser's requirements.

In this case it is significant that the purchasing problem is concerned with bulk supplies for which continuous deliveries are required. This is quite unlike a situation where quantities and specifications are determined by particular circumstances which vary from order to order. This case indicates that in purchasing operating supplies which are bulky in character and which require continuous deliveries in order to avoid the incurring of heavy expense for storage, a purchaser can secure protection against complete stoppage of his supplies by placing contracts for each item with more than one source. If the price from a second source is higher than it would be necessary to pay if purchases were concentrated, the extra price constitutes a premium paid for safeguarding supplies.

November, 1925 M. T. C.

Hemlock Department Store[1]

DEPARTMENT STORE—PAPER BOXES

Purchasing—*Discontinuance of Relations with Supplier Because of Unreliability.* The purchasing agent in charge of buying supplies for the department store decided to make no further purchases from a paper box manufacturing company which, on the first order that he placed with it, failed to fulfil specifications exactly as to the dimensions of boxes for packing waists for delivery to customers. The purchasing agent looked upon that failure as an indication of unreliability, although the discrepancy in size had no effect on the use of the boxes.

(1921)

The Hemlock Department Store, which was located in a southern city, required annually about 10,000 paper boxes for packing waists for delivery to customers. The store ordered those boxes in only one size, 22 inches by 11 inches by 2½ inches. Prior to 1921, the store had made all its purchases of those boxes from the Edwards Box Company,[1] which was about 1,000 miles distant from the store. The store placed two orders each year, in the spring and autumn, for lots of 5,000 boxes, an entire lot to be shipped at one time.

In the spring of 1921, the purchasing agent in charge of securing supplies for the Hemlock Department Store obtained quotations from three manufacturers on 5,000 waist boxes of the size he customarily ordered. One of the companies from which he obtained quotations was situated locally. Its price was higher than those of the other manufacturers, and the purchasing agent did not consider that offer further. The Edwards Box Company quoted a price of $35 per thousand boxes delivered. The Hickory Box Company,[1] located at a distance of about 500 miles from the Hemlock Department Store, quoted a price of $33.75 per thousand boxes delivered. Although he had had no previous experience with the Hickory Box Company, the purchasing agent gave the store's order to that company because of its lower price and the prompter delivery that it could give.

When the shipment of boxes was received from the Hickory Box Company, the purchasing agent examined them thoroughly.

[1] Fictitious name.

The quality of the paper which had been used in making the boxes was equally as satisfactory as that of the boxes previously purchased from the Edwards Box Company, and the boxes were well made and carefully shipped. Delivery from the Hickory Box Company required only one week, while delivery from the Edwards Box Company had taken from ten days to two weeks. The purchasing agent discovered, however, that the boxes were 21¾ inches long instead of 22 inches long as ordered, and no satisfactory explanation of the discrepancy could be secured from the Hickory Box Company. That difference was not enough to be noticed ordinarily, and had no effect on the use of the boxes. The purchasing agent estimated, however, that the difference in length had allowed the Hickory Box Company to save about 250 square feet of material on the order. If the purchasing agent of the Hemlock Department Store forced the Hickory Box Company to meet size specifications in the future, the supplier might slight quality in order to increase its profit or to reduce its selling price below those of its competitors.

Since the purchasing agent of the Hemlock Department Store considered the Hickory Box Company's failure to fulfil specifications exactly an indication of unreliability, he severed his relations with that company and placed the store's order for 5,000 waist boxes in the fall of 1921 with the Edwards Box Company.

COMMENTARY: As the purchasing agent of the department store concluded, in the light of the evidence available, the action of the Hickory Box Company in skimping the size of the boxes delivered indicated unreliability. It was sharp practice. The fact that the store was not injured by the action of the Hickory Box Company does not alter the conclusion. Petty dishonesties and large thefts belong in the same category. The decision of the purchasing agent of the store to sever relations with the Hickory Box Company was commendable.

March, 1926 M. T. C.

Herkimer Steel Company[1]

MANUFACTURER—STEEL

PURCHASING—*Reciprocity Between Manufacturers.* Among other quotations which he obtained from truck manufacturers on ten three-ton trucks, the purchasing agent for the company, which manufactured steel, obtained two quotations which were satisfactory from the point of view of quality, time required for delivery, and price, although the price of one of the truck manufacturers was slightly higher than the price of the other. The manufacturer quoting the higher price recently had become a customer of the steel company; the other manufacturer was not a customer. The purchasing agent had to decide whether to buy at a price differential in order to strengthen the company's relations with its new customer.

(1922)

The purchasing agent of the Herkimer Steel Company, in 1922, received a requisition from the superintendent of the company's Smithtown plant for 10 3-ton trucks to be used for the transportation of employees from the plant to the town. In accordance with the usual procedure, the purchasing agent sent out requests for quotations on these trucks to 15 leading manufacturers. The following quotations of prices and deliveries were received:

Company[2]	Price f.o.b. Smithtown Plant	Time of Delivery
Burroughs Company	$39,500	3 weeks
Bonner Company	41,000	2 weeks
Burwell Company	43,250	1 week
Cutler Company	38,500	2 weeks
Weyburn Company	40,750	4 weeks
Bliss Company	37,400	6 weeks
Stabler Company	42,000	4 weeks
Finder Company	46,500	5 weeks
Humphreys Company	39,500	4 weeks
Heddon Company	38,000	2 weeks

Since the time of delivery was of secondary importance, provided the trucks could be obtained within a month, the decision

[1] Fictitious name.

[2] Fictitious names.

turned on relative prices and quality. Each of these manufacturers had a reputation for making good trucks—some, of course, better than others—but the purchasing agent largely had eliminated the question of quality in selecting the companies to which requests for quotations had been sent.

In determining where to place the order, the purchasing agent's first step was to eliminate from consideration all quotations over $40,000. The quotation of the Bliss Company, although lowest in price, was unsatisfactory, because the purchasing agent had learned that after a recent change in management in the plant the quality of that company's trucks had been lowered; the company also was unable to give prompt delivery. Of the four companies remaining, there seemed to be little choice except on price quotations. All four, in the opinion of the Herkimer Steel Company's engineers, would furnish trucks that would give satisfaction. Because of higher prices, the Burroughs Company and the Humphreys Company were not considered further.

The decision of the purchasing agent then rested between the purchase of Cutler and Heddon trucks. The Herkimer Steel Company had in operation at one of its other plants a fleet of 15 Heddon trucks which had been in service 3 years. The Herkimer sales manager had sent a memorandum to the purchasing agent to the effect that the Cutler Company recently had placed a large order for steel and the day before had written to the sales manager saying that it understood that the Herkimer Steel Company was in the market for trucks and hoped that the Cutler bid would be given careful consideration. The sales manager requested that, if it were possible, the order be placed with the Cutler Company, for he was desirous of cementing the relations between this new customer and the Herkimer Steel Company. The purchasing agent never had bought Cutler trucks but knew from their reputation that in quality they were equal to Heddon trucks.

It had been the policy of the Herkimer Steel Company to have the purchasing and sales departments work in close cooperation. Whenever the sales department obtained a large order, the purchasing department was notified so that it might have this additional information to use when placing orders; and whenever the purchasing department placed an order, the sales department

was notified so that it might use this as a further argument in making sales. Although the Heddon Company had made the lowest bid, it had bought no steel from the Herkimer Steel Company for five years.

The purchasing agent of the Herkimer Steel Company had to decide whether to give the order for the 10 trucks to the Cutler Company, despite the price differential of $500, or to the Heddon Company.

On the forms on which another steel manufacturer, the Madison Tube and Sheet Company,[3] sent out requests for quotations, the following statement was made:

> It is understood that all material manufactured by ourselves or any of our allied companies must be bought from said companies for this work and prices obtained from the nearest district sales office. Alternative bids may be submitted based on material obtained elsewhere.

The following clause was incorporated in the order blank used by the Madison Tube and Sheet Company:

> In accepting this contract the contractor agrees to specify Madison Tube and Sheet Company materials where possible.

COMMENTARY: Inasmuch as the company was operating a fleet of 15 Heddon trucks at one of its plants, some slight gain might have been expected, perhaps, in purchasing the same make of trucks for the Smithtown plant. The advantages of standardizing such accessory equipment between plants, however, were less than the gains from standardization at a single plant. Even though a plan of standardization of accessory equipment throughout the company's various plants were adopted, moreover, the standard selected necessarily would be subject to change when circumstances warranted it, and the situation presented in this case might have been occasion for changing to Cutler trucks as standard equipment. The date when the fleet of Heddon trucks would have to be replaced was approaching. Under these circumstances, the fact that the company previously had purchased Heddon trucks for another plant was not to control the decision. The purchasing agent, according to the case, was convinced that the two makes of truck were of equal quality. The problem thus resolved itself into one of reciprocity in purchasing at a price differential.

The Heddon Company offered the lower price. The Cutler Company was a customer. The steel company naturally desired to retain

[3] Fictitious name.

the favor of all its customers, and the differential involved in this transaction was small, less than 1½% of the price of the trucks. Therein lay the strength of the case for reciprocity in purchasing in this instance. The question was one, however, which should have been looked at from the standpoint of general policy. If reciprocity with the Cutler Company were to have been practiced at a differential of 1½%, then the same practice should have been followed in making other purchases, perhaps at higher differentials. The effect of that policy would have been to increase the Herkimer Steel Company's costs of production. The effect was likely to become cumulative, with a tendency for the sellers to take advantage of their preferred positions.

The Herkimer Steel Company would have expected to receive reciprocal treatment, of course, in selling to customers from which it bought equipment or materials at price differentials. It was not in that direction that the most serious objection to the policy was to be found. The chief snag was the fact that the company had many potential customers from whom it could not make reciprocal purchases. To those customers it would have been necessary to charge higher prices, because of the higher costs incurred through differential reciprocity, or the Herkimer Steel Company would have had to sacrifice profits. Sooner or later the prosperity of the steel company would have suffered. Hence reciprocity in purchasing at a price differential was unsound economically and also would have encouraged laxity in business standards.

March, 1926 M. T. C.

KLAMEX COMPANY[1]

DEPARTMENT STORE—SOAP

PURCHASING—*Maintenance of Relations with Local Supplier Despite Price Differential.* The executives of the company, which owned and operated a department store, were of the opinion that a large part of the store's business depended upon friendly personal relations between the customers and the officers and employees of the store. For that reason, the company, in common with other companies operating department stores in the city, purchased supplies locally even when a substantial price differential was involved. In accordance with this policy the company refused an offer of a non-local firm selling liquid soap, although the price of the company's local supplier was 62.5% higher than that of the non-local firm.

(1924)

The store superintendent of the Klamex Company, which owned and operated a department store in a southern city with a population of about 150,000, purchased all supplies for the store. He always purchased the company's requirements of liquid soap, which were about 1,500 gallons annually, from a local firm, the Willett Supply Company,[1] without asking for quotations from other companies selling soap. The Willett Supply Company manufactured the soap which it sold and also acted as a wholesale distributor for other cleaning materials. In addition to its purchases of soap, the Klamex Company made small purchases totaling about $75 annually from the Willett Supply Company.

In the spring of 1924, the Holden Company,[1] a soap manufacturer located in a city about 800 miles from the Klamex Company's store, attempted to secure an order from the Klamex Company. The price of the Holden Company's soap delivered was 40 cents a gallon, while the Willett Supply Company's price for the same quality of soap delivered was 65 cents a gallon. The Holden Company's products were distributed nationally and had a reputation for high quality. The minimum order which the Holden Company would accept for soap, however, was 5 drums, each containing 55 gallons; the Klamex Company purchased but one drum of soap at a time from the Willett Supply Company.

[1] Fictitious name.

The larger unit purchases required by the Holden Company would make it necessary for the Klamex Company to provide additional storage space. Delivery from the Holden Company would require from 10 days to 2 weeks, while the local company could make delivery the same day the order was placed.

The store superintendent of the Klamex Company, in common with the purchasing agents of the other department stores in the city, had adopted a general policy of making all purchases of supplies locally, in so far as possible, unless the prices of the local firms were 50% or more higher than the prices offered by firms located elsewhere. Prior to the offer of the Holden Company, the store superintendent of the Klamex Company had not received from any non-local supplier an offer acceptance of which would have involved a substantial saving. On the important supplies required by the store, such as merchandise envelopes, paper boxes, wrapping paper, and twine, local manufacturers or distributors had met the prices of non-local companies. The store superintendent had made no effort to obtain price quotations from non-local firms on supplies which the store used in small quantities. The offer of the Holden Company, however, involved a possible annual saving for the Klamex Company of $375 on purchases totaling 1,500 gallons. The Willett Supply Company's price was approximately 62.5% higher than the price of the Holden Company.

The executives of the Klamex Company deemed it advisable to patronize local firms even when their prices were out of line with those of non-local firms, because experience had shown that much of the store's business depended upon friendly personal relations between the customers and the officers and employees of the store. The executives were of the opinion that the loss of a customer's account usually could be traced to a personal feeling rather than to dissatisfaction with the merchandise or the service offered by the store; the friends of a customer who closed his account with the store frequently closed their accounts also. Because of these personal factors, the store superintendent in arranging for printing work, for instance, gave orders to each of the local printers in turn, regardless of price.

By accepting the offer of the Holden Company, the executives of the Klamex Company were apprehensive that the company

might lose the account of the president of the Willett Supply Company. That account amounted to only $500 or $600 a year, but the friends of the president might also refuse to make further purchases from the Klamex Company. In the past, the store superintendent had refused to purchase from a local supplier only when a serious failure to fulfil specifications or promises of delivery had occurred. Such instances had been infrequent, and the accounts lost to the store thereby had not been large. Moreover, in such instances, the Klamex Company simply had transferred its patronage from one local firm to another.

The store superintendent of the Klamex Company decided to continue purchasing liquid soap from the Willett Supply Company in spite of the lower price quoted by the Holden Company.

COMMENTARY: In several respects this case is similar to the Herkimer Steel Company case.[2] In both instances purchases were proposed or made at price differentials in order to curry favor with customers or to avoid antagonizing them. The effects on the purchaser's costs or operating expenses were analogous in the two cases. The Klamex Company, however, in contrast to the Herkimer Steel Company, had purely a local market and its chief competitors were following the same policy. Hence the Klamex Company was not likely to suffer a competitive handicap by giving preferential treatment to local sources of supply. The practice was presumed, I judge, to enhance local business prosperity by "trading at home." Although it may have afforded a temporary stimulus to local businesses, I am skeptical as to its ultimate benefits to the community, for it must have tended to increase the cost of living in the community above that in other communities whose manufacturers and merchants purchased their materials and supplies on a basis of economy.

The amount involved in this particular purchase was small, but the principle was not insignificant, for it was applied to the purchase of other supplies and was followed by other merchants. This local custom resulted in a protective practice which, on a small scale, was similar to a protective tariff for a national market, but with little likelihood that within the small local area competition would be so stimulated as to eliminate the premiums on local purchases.

March, 1926 M. T. C.

[2] See page 360.

Southern Pine Corporation[1]

MANUFACTURER—LUMBER

Sales Organization—*Manufacturer's Sales Branches to Aid Development of New Territory.* A southern lumber manufacturing company, selling chiefly to retailers, wholesalers, contractors, and large users in the south-central parts of the United States, contemplated establishing a sales branch in Boston in order to gain effective entrance to the New England market, which was being served chiefly by large wholesale yards with established relationships with New England buyers.

Warehousing—*Maintenance of Stocks Near Consuming Market to Facilitate Delivery.* A southern lumber manufacturing company, selling chiefly to retailers, wholesalers, contractors, and large users in the south-central parts of the United States, contemplated extending its sales efforts to New England, where lumber similar to the company's was being distributed chiefly by large wholesale yards having established relationships with New England buyers. If the company established a sales office in Boston, as it contemplated, it would have to decide whether to stock lumber there to facilitate prompt deliveries, or to continue its former practice of shipping direct to buyers from its producing mills.

(1922)

In the early part of 1922, the Southern Pine Corporation, which operated lumber mills in Florida and Mississippi, was making most of its sales to retailers, wholesalers, contractors, and large users in the states along the Mississippi and Ohio rivers. The company had done little to develop sales in the New England states or in other Atlantic Coast states north of Virginia. The company sold some shed stock and yard stock, other than timbers, directly to retailers in the northeastern territory, but most of its sales of timbers in that territory were made on commission by a New York firm which distributed the products of several mills.

At this time, however, the company decided to establish a sales office in New York. It was proposed that the company also open a sales office in Boston and, in order to be able to meet competition by giving quick delivery, maintain stocks of timbers in that territory. Up to this time the company had made shipments of

[1] Fictitious name.

timbers directly from its mills on orders from the northeastern territory.

For each of its smaller sales districts, the Southern Pine Corporation employed one salesman. This salesman had an office in the city which he made his headquarters and was assisted by a stenographer. The radius of his territory seldom exceeded 100 miles. Although the salesman usually came into the office for short periods several times during each week, he ordinarily spent but one complete day a week in the office.

In each of the larger territories a chief salesman was in charge, with one or more junior salesmen, a stenographer, and in some instances an office man, to assist him. The chief salesman called upon the more important customers. Under his direction the junior salesmen called upon the other customers and the prospective customers. The chief salesman planned his trips so that he was in the office during parts of three days each week.

At the sales office which it had decided to establish in New York, the Southern Pine Corporation planned to employ four salesmen: one for eastern New York, one for New York City, one for eastern Pennsylvania and northern New Jersey, and one for southern New Jersey, Delaware, and Maryland. These men were to call on retailers, wholesalers, contractors, and others who bought lumber in large quantities. No distributing yard was to be maintained in New York. Shipments would be made directly from the mills by rail or by water.

Yellow pine was distributed in New England, at this time, chiefly by a few large wholesale yards which sold timber and planking to retailers, contractors, railroads, and other large users. These wholesalers held no agencies for mills in the South. The wholesalers customarily employed representatives in the South, usually at Jacksonville, to purchase lumber when prices were favorable and at all times to supply information regarding market conditions. There were three wholesalers in Boston who sold yellow pine almost exclusively, two in Providence, one in New Bedford, one in Fall River, and two in Portland. The Southern Pine Corporation contemplated making an effort to obtain orders from these wholesalers, but was of the opinion that it would be difficult to change their established relationships with other mills.

In New England, spruce largely took the place of yellow pine

in small sizes. Retailers bought this spruce directly from the mills, which usually cut it to order and delivered it in carload or cargo lots. In Boston there were three or four sales offices of companies owning mills in the spruce regions of Maine, Quebec, Nova Scotia, New Brunswick, and Newfoundland.

The demand for yellow pine timbers in New England was not large. Many retail yards received orders for such timbers but once or twice a year. Consequently, retailers did not maintain stocks of the timbers but purchased from wholesalers after receiving orders. This contrasted with the situation in districts outside of New England, where the Southern Pine Corporation frequently sold timbers, as well as planking, directly to retail yards from its mills.

Several large western mills producing Douglas fir recently had employed agents to call on retailers and large contractors in New England. These western companies made shipments directly from their mills either by rail or by steamer through the Panama Canal. The companies, however, planned to establish stocks at points in the East as soon as practicable.

The Southern Pine Corporation was of the opinion that it might be able to increase its sales of timbers in New England by having its salesmen call upon retailers and contractors there and promise them punctual deliveries from its southern mills. In this way the company might secure the business which was going to the large wholesale yards.

The company, however, had had unfortunate experiences when it had guaranteed deliveries of timbers on orders to be shipped directly from its mills. It had been able to obtain from the mills sufficient planking to meet obligations, but occasionally logs of a quality and size suitable for sawing into timbers had not been available when the orders came in, with the result that the company had been forced to purchase timbers at high prices from other mills in order to make deliveries punctually. Because of the difficulty of making satisfactory deliveries directly from its mills, the company contemplated maintaining stocks of timbers in New England.

Commentary: The information presented in this case is too scrappy to warrant an expression of opinion on the question of the establish-

ment of sales branches by the company. The case does afford an interesting example, however, of a situation in which it was desirable to maintain stocks of a bulky material near the points of delivery to enable punctual, and at times prompt, deliveries to be made. The production of large timbers could not be regulated, as in the case of smaller sizes of lumber, in accordance with current demand. Punctual deliveries, and in some instances prompt deliveries, were required by purchasers of timbers for construction work. It was necessary for the company to carry stocks of timbers in order to take advantage of demand as it arose; apparently it was more advantageous from a sales standpoint to carry those stocks near the consuming market than to carry them at the mills.

March, 1926 M. T. C.

Warren Textile Machinery Company[1]

MANUFACTURER—MACHINERY

Sales Promotion—*Concessions in Credit Terms to Secure Initial Sale.* The company, a large manufacturer of textile machinery, produced the first French-system textile machine made in the United States. In order to have at least one of its new machines in operation, and so reduce the sales resistance manifested by potential users of the machine, the company accepted an order from a firm which stipulated credit terms more favorable to itself than those to which the company regularly adhered.

(1922)

In 1922 the Warren Textile Machinery Company produced the first French-system textile machine made in the United States. Because of the distrust which the few worsted manufacturers who were in the market to buy equipment had for the first machinery of this type to be produced by an American organization, the company had difficulty in making sales on its usual terms, which were cash in 30 days from the date of installation. One prospective customer was found, however, who was willing to make a comparatively small installation, involving $175,000, provided the company would grant him terms of 25% cash in 30 days from the date of installation and the remainder in 6 equal installments during the next 3 years, with interest at 6% on unpaid notes.

The new line of machinery seemed to be equal to the best foreign product. The Warren Textile Machinery Company was one of the largest manufacturers of textile machinery in the United States. The company's annual sales were about $20,000,000. Its Bradford type of machinery competed in world markets with the products of European manufacturers. The new product also competed in price with similar French-system machinery produced abroad. Since American worsted manufacturers, however, always had imported equipment of this type, they were likely to doubt at first the ability of the American company to construct as efficient equipment as that produced abroad, even though they recognized the equality and in some instances the superiority of American textile machinery of other types.

The Warren Textile Machinery Company had developed the

[1] Fictitious name.

new line because of the expectation that the line would have a large and growing market. The executives were of the opinion that the Bradford-system machinery and the French-system machinery each had a distinct field of usefulness. For handling long wools and hairs the Bradford-system machinery was highly satisfactory, being simple in operation and construction, flexible, and producing at comparatively low cost. For spinning short, fine wools and mixtures of these with cotton, however, the French-system machinery was superior; on it could be produced good yarns from a stock too short for the Bradford-system unless mixed with longer stock. The executives recognized that the world supply of fine, long-staple wool had been diminishing for some time. Since the market prices were less for the shorter fibers, which could be used satisfactorily on French-system machinery, the executives foresaw the possibility of reduction in yarn costs as a result of extension of the use of machinery of that type.

The company had not been able always to adhere rigidly to its usual credit terms. During the development of the cotton industry in the South, for example, where adequate capital for large fixed investments had not been available, the company often had been forced by competition to accept shares of the stocks of mills in payment for machinery. In the case of the worsted machinery, however, the company feared the establishment of a troublesome precedent if it should depart from the terms to which it had adhered for many years. The amount of capital required to finance all its sales on the terms requested by the prospective customer would have been prohibitive. In order to secure an initial installation, nevertheless, the Warren Textile Machinery Company decided to accept an order for the new French-system machinery on the requested terms of payment.

Commentary: Dependability in operation was one of the chief objects sought by a prospective purchaser of expensive machinery such as the French-system machine produced by the company. Full assurance of dependability could not be given until the machinery actually had been installed and operated in at least one factory. It was worth while, therefore, for the manufacturer to make the concessions requested in order to have one installation for demonstration and thereby to lessen sales resistance.

March, 1926 M. T. C.

Stebbins & French[1]

MERCHANTS—WOOL

Distribution Channels—*Distribution of By-Products through Producer's Own Sales Force.* The firm sold wool to both woolen and worsted mills, chiefly by its own salesmen. Noils, which were produced incidentally in the production of tops for use in making worsted yarn, constituted about 10% of the firm's total sales and were sold only to woolen mills. When the worsted industry was active, the firm's salesmen had difficulty in selling noils, because at such times the woolen industry usually was relatively inactive. For this reason it was suggested that the firm sell its noils by six months' contract to noils merchants instead of directly to woolen mills by its own salesmen. The firm, however, rejected this proposal.

Distribution Channels—*Maintenance of Contacts with Temporarily Inactive Accounts—(Commentary).* The firm sold wool to both woolen and worsted mills, chiefly by its own salesmen. Noils, which were produced incidentally in the production of tops for use in making worsted yarn, constituted about 10% of the firm's total sales and were sold only to woolen mills. When the worsted industry was active, the firm's salesmen had difficulty in selling noils, because at such times the woolen industry usually was relatively inactive. For this reason it was suggested that the firm sell its noils by six months' contract to noils merchants instead of directly to woolen mills by its own salesmen. The firm, however, rejected this proposal. The commentator concurs in the firm's decision, pointing out that it was important for a firm of raw material merchants to maintain continuous relations with all potential customers.

(1922)

Stebbins & French, a firm of Boston wool merchants which had been active in the wool trade for more than 30 years, handled all grades of wool for woolen and worsted mills. It purchased wool from growers in the Far West and also from local wool merchants in the Ohio Valley and similar districts. The firm also imported wool from the British colonies and from South America and wool tops from England. Like other wool firms, Stebbins & French ordinarily bought wool in the grease. It sold wool in the grease, and also scoured or combed when market conditions enabled it to obtain greater profits thereby.

[1] Fictitious name.

The scouring process removed the animal grease from the wool. Ordinarily the wool, as it came from the sheep's back, lost from 50% to 70% of its weight in the scouring process. Wool merchants, in buying wool in the grease, estimated the probable shrinkage in scouring, in order to base their calculations on the price of scoured wool. There were numerous plants to which wool merchants could send grease wool for scouring. The decision whether to have a particular lot of wool scoured before resale depended upon market conditions and upon the preference of the individual mill to which it was to be sold.

The process which differentiated worsted manufacturing from woolen manufacturing was combing. The fibers in a single fleece varied greatly in length. Only the long fibers, however, were suitable for spinning into worsted yarn. It was by the combing process that the long fibers for worsted spinning were separated from the shorter fibers. The strand of long fibers from a combing machine was wound into a cylindrical ball as it came from the machine. This was known as a top. Worsted tops were articles of commerce. The short fibers removed by the combing machine were known as noils. These noils were suited to the manufacture of woolen cloth and were sold regularly for that purpose in competition with short-fiber wool.

A wool comb was an expensive, intricate machine, and ordinarily a worsted mill, if it operated a combing department, was equipped with only enough combs to provide for its normal needs. There were numerous firms, however, which operated combs for combing wool on commission for wool merchants or worsted manufacturers. Several other firms, known as top makers, bought wool, combed it on their own account, and sold the tops to worsted mills and the noils to noils merchants.

Stebbins & French sold wool in the grease and scoured to both woolen and worsted mills. Its total sales ordinarily were about $11,000,000 a year. When market conditions furnished an opportunity, the firm sold tops to worsted spinning mills which operated no combs, to worsted mills which were in need of immediate delivery, and also to worsted mills which required quantities of tops in excess of their combing capacity. Including imported tops, about 60% of the firm's sales were of tops. The noils produced from the wool which Stebbins & French purchased and

had combed on commission were sold by the firm to woolen manufacturers. Noils averaged about 10% of the firm's total sales, occasionally falling as low as 3%.

Stebbins & French employed salesmen to solicit orders from the mills, and occasionally it sold both wool and noils through brokers. Those brokers participated chiefly but not exclusively in transactions between wool merchants. They were intermediaries through whom sales were made chiefly to other wool merchants by firms that had stocks which for any reason they wished to sell quickly. In each instance the seller provided the broker with a sample of the wool and stipulated a minimum price. A broker occasionally was employed by a wool merchant to buy specific lots of wool from other merchants whom the buyer was averse to approaching personally. The broker received a commission of 1% of the selling price; the brokerage fee usually was paid by the seller.

In 1922 two new partners were admitted to the firm of Stebbins & French, and at that time it was proposed that the firm should discontinue its practice of selling noils by its own salesmen. As an alternative, it was suggested that the firm should make a contract with a firm of noils merchants for the entire output of noils of Stebbins & French for the succeeding six months. The argument advanced in favor of the contract with a noils merchant was briefly as follows. During a period when worsted mills were buying both wool and tops heavily, the demand from woolen mills for short-fiber wool and noils usually was less active than normally, the popularity of worsteds indicating a lack of popularity of woolen goods. Consequently, since noils were produced incidentally in the production of tops, the firm had its largest output of noils at the very time that there was least demand for them. It might be advantageous, therefore, if when the worsted industry was most active the firm's salesmen could concentrate on the sale of tops and wool without undertaking to sell noils. The proposed contract with a noils merchant would make this possible, relieve the firm of price risks on noils, and enable it to avoid carrying charges.

Woolen manufacturers usually bought noils wherever they could secure them to best advantage, although some woolen manufacturers preferred to buy noils from the same firms from which

they purchased wool. The new members of the firm pointed out that a noils merchant had an advantage in the noils trade because he could be relied upon as a regular source of specific grades of noils, while in the case of a wool merchant selling noils the noils trade was incidental, and the quantity and grades of his stock of noils fluctuated.

The older members of the firm stated that the firm had been reasonably successful with its own policy, and that they were not willing to agree to entering into such a contract as was proposed.

Commentary: This firm normally sought to sell wool and noils to woolen manufacturers and wool and tops to worsted mills. The purchases of the mills were governed by the popularity of the different fabrics which they were producing. Under some conditions the company's sales were chiefly to worsted manufacturers and under other conditions chiefly to woolen manufacturers. At all times, however, it was essential for a firm of merchants of this type to maintain relationships with all potential customers, and even when the worsted industry was the more active woolen manufacturers made some purchases of wool and noils. In order to maintain relationships with customers the firm's salesmen would have occasion to call upon woolen mills even when the worsted industry was the more active, and the firm properly decided that the salesmen should be expected to sell its noils. Such sales of noils and wool as were made to woolen manufacturers under those conditions would help to meet the expense of maintaining relationships with that class of customers and would enable the company to take advantage of any increase in demand.

March, 1926 M. T. C.

A. W. Bell Oil Company[1]

MANUFACTURER—OIL

Warehousing—*Maintenance of Stocks Near Consuming Market to Facilitate Delivery.* In order to give prompt delivery to customers and to save in freight charges by shipping in car lots, the company, which was located in Chicago and manufactured oil chiefly for sale to industrial users, decided to maintain stocks in a public warehouse in Minneapolis. For several years the company had maintained stocks in St. Louis, and the executives ascribed the increased sales volume in that district to the improved delivery service to customers.

(1924)

Since 1921 the A. W. Bell Oil Company, of Chicago, had maintained stocks in a public warehouse in St. Louis, in order to be able to give prompt delivery to customers in that district. In 1924 it was proposed that the company should also maintain stocks in Minneapolis.

The A. W. Bell Oil Company manufactured lubricating oils and greases, and, in addition, refined and marketed fish oil which it purchased from eastern oil extractors. In 1924 approximately 50% of the company's sales, both in quantity and in value, were of cutting lubricant, which the company sold to machine-shops and factories at about $15 a barrel. Twenty-five per cent of the sales were of foundry oil, the price of which was about $25 a barrel to industrial users. This oil, when mixed with foundry sand and foundry flour, caused the mass to cohere. The remaining 25% of the sales were of lubricating greases, fish oils, and branded oils. The company sold the branded oils to textile mills, the lubricating greases almost exclusively to the manufacturers of automobiles in Michigan, and the refined fish oils chiefly to the manufacturers of paint and the makers of linoleum. On sales to wholesalers the company's prices were 25% less than the prices which it quoted to industrial users. The company's terms were 1% 10 days, net 30 days.

The company sold its product by means of its own salesmen. It maintained a branch sales office and warehouse in Detroit. Six salesmen had headquarters at that office. One salesman's terri-

[1] Fictitious name.

tory was Kalamazoo, another's was Toledo, and the remaining four sold in and near Detroit. Five salesmen operated directly from the home office in Chicago and sold oils and greases to the industries in that district. Nine other salesmen were under the control of the Chicago office, but traveled in assigned districts throughout the Middle West. One of these nine salesmen maintained a permanent office in St. Louis.

The company's salesmen called on the purchasing agents of factories and railroads and the foremen or superintendents of machine-shops about once in every two weeks. In areas where industrial plants were not concentrated, the salesmen's calls on individual customers sometimes were as infrequent as once a month. The typical purchase was one barrel of oil at a price of from $15 to $25. There was no regular frequency of purchase. Customers seldom maintained reserve supplies of oil.

The remuneration of the company's salesmen varied with their experience and ability. In general, each salesman was given a drawing account of $150 a month and a commission of 15% on his sales. The company considered any salesman satisfactory whose total expenses to the company were less than 20% of his sales. The company's average gross margin was 30%. The margin was higher on branded oils such as were sold to the textile industry and lower on the staple lines of greases and oils. Approximately 7% of sales was required to meet the overhead expense of the sales offices in Chicago and Detroit.

In 1921, when the company's sales in the St. Louis district had been approximately 10 barrels a month, the company had arranged to store stocks of its products in a public warehouse in St. Louis at the rate of 20 cents a barrel per month plus a handling charge of 5 cents a barrel; the handling charge was independent of the length of storage. The company made shipments to St. Louis in car lots of 70 barrels. The freight rate on car lots was about one-third less than the rate on less than car lots. The less-than-car-lot rate was approximately 60 cents a barrel, 4% of the sales price of the company's cutting lubricant. As a result of the large unit shipments to St. Louis, the rate of stock-turn there was less than the rate for the stocks at the factory, where the stock-turn was 12 times a year. After the company provided for stocks at St. Louis, its sales in that district increased from 10 barrels a month to 40 barrels a month.

The A. W. Bell Oil Company had been one of the first lubricating manufacturers to maintain stocks in St. Louis. The executives ascribed the increase in sales which had followed the establishment of stocks to better service to existing customers and to the company's ability to make prompt deliveries on rush orders. Some machine-shops and factories invariably waited until their supplies of oil were exhausted before placing orders for more. A shipment by freight from Chicago to St. Louis, a distance of about 300 miles, required from 4 days to a week, the exact period in each instance depending upon traffic conditions. It had been the company's experience that many purchasers were unwilling to wait as long as that for deliveries. An additional advantage of the company's plan of maintaining stocks in St. Louis was the saving on freight charges which could be realized by shipping in car lots.

In Minneapolis, located 400 miles from Chicago, the company was selling 30 barrels of oil a month. Most of the company's competitors already were maintaining stocks in Minneapolis. The company could obtain the use of public warehouse facilities in Minneapolis at prices similar to those which it paid in St. Louis. Because of the advantages which it believed had resulted from the maintenance of stocks in St. Louis, the company decided to maintain stocks in a public warehouse in Minneapolis.

Commentary: The chief significance of this case is the evidence which it furnishes of the effect of facilities for prompt delivery on sales of supplies. If the sales in the St. Louis district had not increased, the savings in freight expense which resulted from shipping in car lots instead of in less than car lots would not have been sufficient to cover the warehouse charges on car lot shipments. Inasmuch as the sales increased from 10 barrels a month to 40 barrels a month in the St. Louis district after the new policy was put into effect, the savings realized from shipping in car lots were almost sufficient to offset the warehouse and handling charges which were incurred, and the company presumably benefited from the greater volume of sales. The increase in the quantity of oil sold by the company in St. Louis when it became possible to make immediate delivery from warehouse stocks measures roughly the influence of prompt delivery as a motive for patronizing a particular company in the purchase of such supplies.

April, 1926 M. T. C.

Hotel Rantan[1]

HOTEL—GLASSWARE AND KITCHEN UTENSILS

Purchasing—*Prompt Adjustment of Claims for Breakage as Patronage Motive.* Because the wholesale firm from which he had been purchasing glassware and kitchen utensils consistently delayed adjustment of claims for breakage occurring in delivery, the assistant manager in charge of purchasing for the hotel decided to purchase those items from another supplier, although that supplier's prices were slightly higher. The amounts of the claims for breakage were comparatively small, but the attitude of the supplier made it necessary for the assistant manager to devote a disproportionate amount of his time to the collection of claims. Moreover, the assistant manager believed that prompt adjustment of claims tended to reduce carelessness in making shipments.

(1924)

The annual requirements of the Hotel Rantan for replacements of glassware and kitchen utensils involved an expenditure of about $9,000. In 1924 there were in the city in which the hotel was located two wholesale distributors of those products, the Merriman Company[1] and the Busseter Company.[1] The Busseter Company had been established in 1921; the Merriman Company had been in existence when the hotel was opened in 1915. The prices of the Merriman Company were on an average from 5% to 10% higher than those of the Busseter Company. Although the Merriman Company's merchandise was slightly superior in quality to the merchandise of the Busseter Company, the assistant manager in charge of the hotel's purchasing department had secured most of the hotel's requirements of glassware and kitchen utensils from the Busseter Company since 1921. He made from 10% to 20% of the purchases from the Merriman Company, however, because of incompleteness in the lines, or shortage in the stocks, of the Busseter Company. Although quality was an important consideration in the purchase of supplies for the hotel, since the managers wished to maintain the reputation which the hotel had for being the best in the city, the merchandise purchased from the Busseter Company had been satisfactory. In the autumn of 1924, however, because of

[1] Fictitious name.

the Busseter Company's failure to make prompt adjustments of claims for pieces broken in delivery, the assistant manager of the Hotel Rantan considered purchasing glassware and kitchen utensils exclusively from the Merriman Company.

Each year, the Hotel Rantan had placed with the Busseter Company claims amounting to about $50 for pieces broken in delivery. Since the spring of 1923, the Busseter Company had attempted to avoid payment of such claims and consistently had delayed adjustments until it became evident that the account of the Hotel Rantan would be lost unless the claims were settled at once. The Merriman Company, on the other hand, always had made adjustments promptly. The percentage of breakage on deliveries had been about the same for the Merriman Company as for the Busseter Company.

Although the amount of the claims was small, the assistant manager desired to secure prompt adjustments in order to prevent the supplier from becoming careless in the shipment of merchandise sold to the hotel. Moreover, the difficulty encountered in securing payment on claims was an inconvenience to the assistant manager, whose time was needed for supervision of hotel operations.

The assistant manager of the Hotel Rantan decided to place all future orders for glassware and kitchen utensils with the Merriman Company and to secure from the Busseter Company only those pieces which the Merriman Company could not supply because of incomplete lines or exhausted stocks.

Commentary: In this case the amount of the monetary saving in purchasing supplies from the Busseter Company was more than counterbalanced, in the judgment of the assistant manager of the hotel, by the loss in his own time and the irritation involved in the collection of claims from that company. The attitude manifested by the Busseter Company in making adjustments, moreover, was not conducive to unreserved confidence in its integrity in other dealings. The case serves particularly as an illustration of prompt adjustment of claims as a patronage motive.

March, 1926 M. T. C.

Albertson Company[1]

DEPARTMENT STORE—TAGS AND LABELS

PURCHASING—*Maintenance of Established Relations Despite Price Differential.* Because its relations with its customary supplier of tags and labels had been entirely satisfactory, the company, which owned and operated a department store, continued to purchase from that supplier although it could have purchased at slightly lower prices from another manufacturer.

(1924)

The Albertson Company, which owned and operated a department store in Cleveland, Ohio, used annually about 100,000 printed gummed labels and an equal number of printed price tags. Prior to 1924 these had been supplied by the Mosely Tag Company,[1] located in Columbus. In that year, a salesman of the Laynard Tag Company,[1] also of Columbus, called upon the purchasing agent of the Albertson Company for the first time. That salesman quoted prices of $4.21 a thousand on printed gummed labels and $3.45 a thousand on printed price tags. The prices of the Mosely Tag Company were $4.35 a thousand labels and $3.50 a thousand tags.

Prior to 1924 it had been the experience of the purchasing agent of the Albertson Company that tags or gummed labels equal in quality to those supplied by the Mosely Tag Company could not be obtained elsewhere at satisfactory prices. In 1922 the Albertson Company had made a purchase of tags from a local manufacturer. The printing on those tags had not been up to the standard desired by the company; the dye with which the strings were colored had rotted the strings so that the tags fell off the garments to which they had been attached.

The samples offered by the Laynard Tag Company in 1924 compared favorably with those of the Mosely Tag Company. The prices quoted were lower. The Laynard Tag Company offered to make delivery within one month, while frequently it had been difficult to secure delivery in less than two months from the Mosely Tag Company, because of the volume of unfilled orders at that company's plant. The Mosely Tag Com-

[1] Fictitious name.

pany, however, always had made deliveries on the dates promised. The reputation of the Laynard Tag Company for punctuality of delivery also was good.

The Mosely Tag Company had manifested a strong desire to make prompt and satisfactory reparation for any mistakes for which it was responsible. In 1923 a shipment of 10,000 gummed labels from the Mosely Tag Company had been unsatisfactory, as it had been impossible to prevent the labels from rolling. The purchasing agent of the Albertson Company had informed the manufacturer of this condition. The manufacturer had offered to take back all labels which had not been used, and to allow any adjustment which the purchasing agent requested on the price of the remainder. The purchasing agent had suggested 20% as a satisfactory figure, and the Albertson Company had been reimbursed for that amount. The unused labels had been replaced and the salesman of the manufacturer had called to state that every precaution would be taken to prevent a recurrence of the trouble.

At another time, the purchasing agent had sent the Mosely Tag Company a design for a new tag to be used on corsets. The type of tags used previously had been unsatisfactory because the tags were easily bent or broken. The purchasing agent had asked for samples and for an estimate of price on the new type of tags. At the end of a week, he had received a letter from the manager of the research department of the Mosely Tag Company asking if the Albertson Company would be willing to change to another design. That design was accepted and proved to be entirely satisfactory.

The purchasing agent liked the personality of the salesman of the Mosely Tag Company and would rather give the orders to him than to the salesman of a competitor, provided the combination of quality, price, and service given by the Mosely Tag Company was as high as that offered by the competitor. Prompt delivery was not so essential with tags and labels as with other items such as wrapping paper, folding boxes, and twine, since the little space which was required for storage of tags and labels made it possible to maintain relatively large stocks.

Because of the cooperative attitude of the Mosely Tag Company and the personality of its salesman, the purchasing agent

of the Albertson Company gave no orders in 1924 to the Laynard Tag Company, but continued to secure the store's total requirements of printed tags and gummed labels from the Mosely Tag Company.

COMMENTARY: The aggregate saving which the Albertson Company would have realized by purchasing its year's supply of labels and tags from the Laynard Tag Company instead of from the Mosely Tag Company was $19. The readiness with which the Mosely Tag Company made adjustments on unsatisfactory goods, the prompt assistance that company rendered in devising new types of tags for special purposes, and the advantages of continuing established relationships clearly outweighed the small saving that could have been effected by purchasing from the Laynard Tag Company.

April, 1926 M. T. C.

Lambert Lake Gas Company[1]

PUBLIC UTILITY—COAL

Purchasing—*Purchase of Essential Operating Supply by Annual Contract or in Spot Market.* The company, a public utility engaged in the manufacture of gas, customarily contracted annually with a coal mining company for its year's requirements of coal. The contract provided for reductions in shipments in the event of causes beyond the control of either the seller or the purchaser and also for changes in the price in accordance with changes in labor rates. In 1922 the public utility company thought that it might be advisable to discontinue the annual contract plan and to purchase coal, in the spot market in the producing region, as needed. The company in 1921, because of transportation difficulties, had been unable to obtain shipments under the contract when needed; it was the company's opinion, moreover, that the price of coal would decrease substantially in 1922 and that the advantage of such reduction would be lost if a year's contract were entered into.

(1922)

The daily consumption of coal of the Lambert Lake Gas Company was about 500 tons. In order to be assured of a continuous supply, the company normally stored 60 days' requirements at the plant. The coal used in the manufacture of gas was of a highly volatile type. The company had confined its purchases to one district in West Virginia. Until 1921 the Lambert Lake Gas Company had placed a contract each year in March for its annual coal supply. The contracts had been given regularly to the same company. Each was a typical coal contract which contained a provision that: "In case of strikes, accidents, or other causes beyond the control of the seller, or hindrances interfering with the mining and shipping of coal, the shipments will be reduced in the same proportion as the rated capacity of mines from which this coal is supplied is curtailed. The buyer is likewise entitled to suspend or reduce shipments of coal when similar causes beyond the buyer's control interfere with the operation of the buyer's use of said coal." It was provided further that: "The price named in this contract is based upon the existing rates of pay for all mine labor and the price will be subject to readjustment in the event existing rates of pay are changed."

[1] Fictitious name.

Early in 1921 a question was raised as to the advisability of a continuance of the annual contract plan. Coal and labor prices in general were falling. Another disturbing element was transportation difficulties. The experience of the Lambert Lake Gas Company had been that coal contracts were binding upon the purchaser in that he was required to take the coal as delivered under the terms of a contract; yet in case of mining or transportation difficulties no means had been devised to enforce or insure deliveries. In 1920, when railroad difficulties handicapped the coal company in making deliveries, for example, the gas company had waited in anticipation of a resumption of shipments until the supply on hand at the plant had become so low that a shut-down was threatened. Consequently, in order to supply gas to its customers, the company had been forced to enter the open market and purchase spot coal at a price much higher than the contract price. In view of this experience, the contract, which normally would have been let in March, 1921, was not signed until June 1 of that year.

In February, 1922, shortly before the calling of a coal strike in all the nearby union fields, the coal company notified the gas company that the price of coal was to be advanced 40 cents a ton. This increase was considered just by both companies on the ground of higher production costs. Although the rates for the sale of gas fixed by the local public utilities commission had enabled the gas company to show satisfactory net earnings in 1921, this increase of 40 cents a ton in the price of coal left small margin for contingencies. In February, 1922, the coal company also asked the gas company to renew its contract for 1922. Its experience during the preceding two years made the gas company reluctant to assume a long-time contract. In addition, it was expected that the price of coal would decline nearly to the pre-war level later in the year. The coal company was in a non-union district, and although entirely surrounded by union fields, little labor trouble was anticipated; the company always had paid as liberal wages as were paid in union mines. The coal company also owned a large supply of private cars. The Lambert Lake Gas Company was located near the seaboard so that deliveries were possible by either rail or rail and water. By rail the distance from the mines was about 700 miles through

congested gateways and junctions. The rail and water route was 400 miles from the mines to tide-water and 500 miles from tide-water to the port nearest the Lambert Lake Gas Company.

By failing to sign the contract and relying upon the West Virginia open market, the gas company would have to take into consideration the fact that the gas coal fields were small and not widely separated. It was probable that the transportation problems of one field would be the same as those experienced by neighboring producers. The contract contained so many safety clauses in case of mining or transportation difficulties that there was practically no legal obligation on the part of the coal company to make deliveries in emergencies. At the time that the contract was offered, it was believed by the gas company that little could be gained by acceptance and that advantages of price declines later in the year might be lost.

Commentary: The gas company, in this instance, was purchasing coal from a mining company. No evidence is presented as to the relative advantages in buying from the mining company instead of from a coal dealer; hence that point is not to be taken up here. The provisions in the contract with the mining company whereby in stipulated contingencies the seller could deliver less than the specified quantity of coal without violating the contract nominally were counterbalanced by the clause which relieved the buyer from accepting deliveries under stated conditions. The latter clause was a real protection for an industrial company, which might suffer a shut-down of its plant, but it had little significance for a public utility company, which of necessity had to keep its plant in continuous operation. The clause which provided for changes in prices when wage scales changed worked in either direction; that is, the price was reduced when wages were lowered or raised when wages were increased.

Despite the lack of assurance of delivery under the stipulated contingencies, the annual contract method of purchasing coal was generally advantageous to the Lambert Lake Gas Company, and the company should have renewed its contract in 1922. The instances in which the coal company would fail to make deliveries would be of rare occurrence, and that risk would be more than offset by the gains from the use of the contract. The gas company required a continuous flow of coal, and without a contract would have had the burden of continually negotiating purchases. Without a contract, to be sure, it occasionally might have been able to buy spot coal at prices substantially below the contract price. In other instances it would have had to pay spot prices

much higher than the contract prices. The prices paid under the contract were subject to adjustment when wage scales changed, but, with changes in general business conditions, spot coal prices fluctuated much more widely than contract prices.

Inasmuch as the value of the coke and other by-products produced in a gas plant usually covers a large part of the cost of the coal used, the price paid for coal tends to be of less significance than certainty of delivery and assurance of receiving the proper quality. Even though the price of coal was not a major factor in rate-making, however, it could not be entirely ignored. By purchasing in the spot market the company would have been following a speculative buying policy, and in the event of having to pay very high prices for coal it hardly could have expected the public service commission to permit it to adjust its rates to such a basis. On the other hand, it fairly could have requested higher rates if contract coal prices rose so high as to make its previous rates unremunerative. Whatever the merits of speculative purchasing of basic materials may be for a private industry, that practice is not to be commended for a public utility company.[2]

March, 1926 M. T. C.

[2] For a case on the purchase of coal by an industrial company, see Jamieson Paper Company, page 389.

Jamieson Paper Company[1]

MANUFACTURER—PAPER

Purchasing—*Maintenance of Stocks by Seller for Purchaser.* Because the firm from which it purchased coal did not make prompt or regular deliveries, this company, a manufacturer of paper, had to carry large stocks of coal. Delays in unloading, furthermore, caused the company to incur heavy demurrage charges. Another coal company offered to maintain adequate stocks and to make daily deliveries to the manufacturer at a price somewhat higher than the manufacturer then was paying.

(1919)

For several years prior to 1915 the Jamieson Paper Company, located in New England, had purchased its supply of bituminous coal on contract from Nova Scotia for about $2 a ton. In that year, however, the influence of the World War on shipping facilities and rates caused this favorable arrangement to be discontinued. For the next four years the company procured its coal either on contract or in the open market, wherever the best opportunity offered, and greater attention was given to delivery dates than to prices. When the price of coal rose, the company made corresponding increases in the selling prices of the paper which it produced.

In 1919 the Jamieson Paper Company was purchasing a large portion of its supplies of bituminous coal from the Seamsford Mining Company,[1] but that coal company had difficulty in maintaining prompt and regular deliveries, and, consequently, the Jamieson Paper Company occasionally was forced to curtail production. In purchasing coal from the Seamsford Mining Company the Jamieson Paper Company had found it necessary to keep a 60 days' supply, at least 20,000 tons, in storage at its plant in order to insure steady operations. The Jamieson Paper Company used approximately 400 tons of coal daily, of which two-thirds were bituminous and one-third anthracite screenings. At the prices which were current in 1919, 60 days' supply of bituminous coal represented an investment of from $150,000 to $200,000. Because of unavoidable delays in unloading, furthermore, demur-

[1] Fictitious name.

rage charges commonly amounted to about 50 cents a ton. Another disadvantage of storing the bituminous coal was its susceptibility to fires in the storage pile.

In an effort to increase its sales of bituminous coal, the Wright Mining Company,[2] in 1919, offered to enter into a contract with the Jamieson Paper Company for a year's supply of bituminous coal. The proposed contract contained a provision which would permit renewal at the end of the year on the same terms. The Wright Mining Company had dock facilities at seaboard about 5 miles from the plant of the Jamieson Paper Company; hence, the supply of coal to be carried by the paper company could be reduced to 7,000 tons. The Wright Mining Company's coal, however, was less suited to the paper company's needs and burned more slowly than the Seamsford coal. The practice of buying coal on a B.t.u. basis had been discontinued by the Jamieson Paper Company earlier in 1919 because of continued haggling as to the relative accuracy of analyses made by its chemist and those of the supplying companies. The mining companies constantly protested the figures of the Jamieson Paper Company and stated that the latter's chemist had selected poor samples not representative of an entire shipment. In considering the offer of the Wright Mining Company, therefore, the question of the use of a B.t.u. basis did not arise.

The terms offered by the Wright Mining Company provided that an extra charge of 30 cents a ton above the price paid the Seamsford Mining Company was to be made for the use of the specially constructed dock and storage facilities of the Wright Mining Company. This price differential was to cover the mining company's additional handling costs. The Wright Mining Company would agree to keep in storage at least 25,000 tons at tidewater and to supply the Jamieson Paper Company daily as needed, provided the Jamieson Paper Company agreed to buy its entire supply of bituminous coal, up to 75,000 tons a year, from the Wright Mining Company. This arrangement would reduce demurrage charges and insure steady deliveries to the paper company. If the needs of the Jamieson Paper Company exceeded 75,000 tons of bituminous coal, the Wright Mining Company would assume no obligation to supply the extra quantity required.

[2] Fictitious name.

The Wright Mining Company would agree not to sell to any other consumer at a price lower than that quoted to the Jamieson Paper Company. The price was to be fixed on the first of each month; it was understood that changes in ocean freight rates and in market conditions might necessitate revision. No maximum or minimum price was stipulated, but the Wright Mining Company was held to be a thoroughly reputable firm.

COMMENTARY: The decision in this case apparently should have turned on relative costs. Fuel was one of the major items of cost. In comparing costs of coal from the two sources, the first item beyond the initial price was the interest on the investment in 60 days' stock of coal carried under the existing plan. This, computed at 5%, represented about 37½ to 50 cents a ton. When allowance was made for occasions when stocks ran below 60 days' supply, this interest charge might be expected just about to offset the extra charge of 30 cents a ton to be made by the Wright Mining Company for carrying a stock and delivering coal daily to the mill. By purchasing from the Wright Mining Company, furthermore, the cost incurred by losses from fires in the storage pile would be eliminated.

According to the statement of the case, demurrage charges of 50 cents a ton commonly were incurred under the existing purchasing arrangement. It seems hardly credible that such heavy demurrage charges necessarily were of *common* occurrence. Against the item of cost of these demurrage charges, whatever their frequency, was to be reckoned, in part at least, the extra cost which would result from using the Wright Mining Company's coal, since that was less suited to the paper company's needs and burned more slowly. The difference in the quality of the coal apparently would not affect the quality of the paper company's product, but it would be reflected in costs.

The decision in this case, therefore, turned upon an analysis of the comparative costs per ton of product for fuel obtained from the two different sources. Carrying costs, demurrage charges, and variations in cost arising out of differences in quality, as well as prices quoted, had to be included in the cost analysis. This case affords an excellent example of the necessity of including interest on investment as an item of cost.

November, 1925 M. T. C.

Windermere Dry Goods Company[1]

WHOLESALER—DRY GOODS

Pricing—*Variance of Prices at Salesmen's Discretion.* The company, a wholesale dry-goods firm, authorized its salesmen to vary prices to customers between fixed limits. Although this practice was common among its competitors, the company considered the adoption of a one-price policy.

The Windermere Dry Goods Company, a wholesale firm, had annual sales amounting to approximately $1,200,000. The sales territories of the company were divided into three classes: city, suburban, and country. The city trade was that within a few miles of the warehouse; the suburban trade included the territory outside the city district but within 25 or 30 miles of the warehouse; and the country districts were those that were more remote.

Each salesman in the city districts had a drawing account which was credited with 25% of the gross margin on his sales. The drawing account of each salesman in the suburban districts was credited with 30% of the gross margin on his sales. The drawing account of each salesman in the country districts was credited with 40% of the gross margin on his sales. The drawing accounts of the salesmen covered both salaries and traveling expenses.

The gross margin on sales was based on the cost of the goods delivered at the warehouse. Salesmen were not given the benefit of an increase in the value of merchandise on hand, nor was the gross margin on which their commissions were based reduced by a decline in the market value of goods on hand. The firm retained the speculative profits of a rising market and bore the losses of a falling market. Allowances to customers and cash discounts taken by customers were deducted from the sales before gross margin was determined. At the end of each year the ratio of losses from bad debts to sales was computed, and this average percentage was deducted from the sales of each salesman before the gross margin on which his commission was paid was determined.

[1] Fictitious name.

The salesmen were given price limits on each article, a minimum and a maximum price.[2] Within those price limits a salesman might use his discretion in varying prices for bargaining with customers. Price variations were made irrespective of the quantity of merchandise sold on each order. Numerous competitors, but not all competitors, followed the same plan of using price limits. Competition was keen, and many retail customers preferred to bargain for price concessions in placing orders with the salesmen.

The question was raised whether the Windermere Dry Goods Company should continue to permit its salesmen to vary prices, or should adopt a one-price policy.

Commentary: The company's practice of varying prices between customers was common among wholesalers. It pleased those customers who enjoyed bargaining and who prided themselves upon their bargaining ability. The fact that numerous competitors were following the same practice, furthermore, was an obstacle to the adoption of a one-price policy, for these competitors inevitably would have quoted prices to favored customers below the standard prices which the Windermere Dry Goods Company could have quoted under a one-price plan.

The practice of varying prices between customers, nevertheless, was unfair. It penalized those customers who were poor bargainers in favor of their shrewder competitors. It betrayed the confidence of those customers who accepted the company's quotations in good faith and placed orders without higgling.

Despite the obstacles to the inauguration of a one-price policy, the company should have adopted a plan under which the same price was quoted to all customers at any one time for a given quantity and quality of merchandise. Although competitors would have quoted lower prices to favored customers, at least on some articles, the Windermere Dry Goods Company's prices under a one-price plan would have been no higher than the average prices under a varying price plan and would have been lower than competitors' prices to non-favored customers. Hence, if under a one-price policy the company would have lost sales in some instances to competitors, it should have gained at least an equal amount at other points. The company also could have capitalized the fairness of a one-price policy and so have enhanced the confidence

[2] For a statement regarding similar practices in the wholesale grocery trade, see Bureau of Business Research, Harvard University, Bulletin No. 14, *Methods of Paying Salesmen and Operating Expenses in the Wholesale Grocery Business in 1918*, pp. 14-15.

of its customers in its integrity. A one-price policy, moreover, would have caused the company's salesmen to throw their emphasis upon the quality of the merchandise offered and the service rendered by the company rather than upon price.

April, 1926 M. T. C.

Dallet Company[1]

DEPARTMENT STORE—SALES BOOKS

Purchasing—*Discontinuance of Relations with Supplier Because of Varying Price Policy.* Upon learning that the purchasing agent of the department store was considering a competitive offer of sales books, the salesman of the manufacturer from whom the store usually purchased sales books made successive reductions in price. The purchasing agent concluded from the salesman's action that the manufacturer was following a varying price policy and had overcharged the store in previous years. The purchasing agent also objected to the fact that this salesman undertook to dictate when the order should be placed and the manner in which shipments would be made. The purchasing agent decided to change his source of supply for sales books.

(1923)

The Dallet Company, which owned and operated a department store in New England, had purchased its total requirements of sales books since 1915 from the Eshleman Sales Book Company.[1] That company's plant was in Michigan, but the company maintained an office and a resident salesman in the city in which the Dallet Company was located. The Dallet Company used about 50,000 sales books each year. The Eshleman Sales Book Company supplied the store with sales books in 1923 at a price of $56 a thousand.

In 1923 the Dallet Company had employed a new purchasing agent. In November of that year, he was called upon for the first time by a salesman of the Padgett Company,[1] which was located in a city about 150 miles from the Dallet Company's store. The salesman offered to supply the store's requirements of sales books in 1924 at $42 a thousand. When the salesman of the Eshleman Sales Book Company learned that the purchasing agent of the Dallet Company was considering a competitive offer, he quoted a price of $47 a thousand. The purchasing agent told him that his price was too high and he reduced it to $43, and subsequently to $42, a thousand, the price quoted by the Padgett Company.

The Dallet Company's relations with the Eshleman Sales

[1] Fictitious name.

Book Company had been satisfactory. No trouble had been experienced with the quality of the product or with the punctuality of delivery. The details of each transaction had been carried out promptly and courteously by the manufacturer. Because of its experience the Eshleman Sales Book Company, moreover, had an exact knowledge of the Dallet Company's requirements. Since the Dallet Company had made no purchase from the Padgett Company, the purchasing agent had no assurance that quality or service would be satisfactory. The application of the Mullen test to the samples submitted by both manufacturers showed that the paper stocks used in the sales books were about equal in quality. Whenever the store's customary supplier of an item and another company offered merchandise equal in price and quality, the purchasing agent generally gave orders to the company with which the store had maintained relations previously.

When the salesman of the Eshleman Sales Book Company made his final quotation to the Dallet Company, he stated that the Dallet Company would have to take the 50,000 sales books within one year and in three shipments. In previous years deliveries had been made in from three to five shipments. Deliveries would be made in from four to five weeks from the dates when requisitions were made. In an emergency, the company could supply the store with blank books within three weeks. The salesman stated, furthermore, that if the contract were not arranged within three weeks, the Eshleman Sales Book Company would not be able to supply the Dallet Company's requirements during 1924.

The salesman of the Padgett Company offered to make deliveries within two weeks from the dates when requisitions were made, and said that delivery within one week would be possible in an emergency. He said that he would deliver personally a small quantity of sales books within three or four days after the order was placed, if the store needed the books within that time. The Dallet Company would have to take the 50,000 sales books within one year, but the salesman stated that he anticipated no trouble if the period should be extended one or two months. Shipments would be made in the quantities and on the dates specified by the Dallet Company.

The purchasing agent expected to take at least 12,000 sales

books in each shipment and the total order within one year, no matter to which company he awarded the contract. Prompt delivery was not essential, since requests for shipment were made well in advance of needs.

Because of the discrepancy between the prices quoted by the Eshleman Sales Book Company in 1923 and in 1924, the purchasing agent concluded that the company had made exorbitant profits on sales to the Dallet Company in previous years. He did not approve, moreover, of the salesman's successive reductions in price to the competitive level, since it appeared that the salesman was authorized to charge customers the highest price possible. Neither did the purchasing agent like the action of the Eshleman Sales Book Company's salesman in dictating when the order should be placed and the manner in which shipments would be made. The purchasing agent decided to give the contract for the Dallet Company's requirements of sales books for 1924 to the Padgett Company.

COMMENTARY: The Eshleman Sales Book Company obviously was pursuing a varying price policy. The attitude of the purchasing agent of the Dallet Company toward the Eshleman Sales Book Company after the experience cited in this case shows the resentment which commonly is felt by a purchaser who discovers that he has not been receiving most favored treatment under a varying price policy. The risk of disclosures, which will cause resentment among customers, as in this case, is one of the disadvantages of a varying price policy.

April, 1926 M. T. C.

Tanter Manufacturing Company[1]

MANUFACTURER—WRAPPING PAPER

Purchasing—*Relations with Supplier Manifesting Dishonesty.* Upon discovering that the firm from which it customarily purchased wrapping paper had been shipping a lower grade than was specified in the orders and reported in the invoices, the company discontinued relations with that supplier. Several years later the supplier made persistent efforts to obtain further orders from the company by quoting low prices. The company decided to take advantage of the low prices quoted, but to protect itself by purchasing no more than 20% of its requirements from that source.

(1924)

The Tanter Manufacturing Company each year used large quantities of paper for wrapping its products before they were placed in cartons. In 1921 a new purchasing agent of the company discovered that the North Company,[1] a local wholesale paper distributor which supplied 80% of the Tanter Manufacturing Company's requirements of wrapping paper, for some time had been shipping a grade inferior to that specified in the orders and reported in the invoices which were received. The price of the inferior grade of paper was several cents a pound less than the price of the paper which the Tanter Manufacturing Company had ordered. As soon as his inquiries had convinced him that the delinquency of the North Company was intentional, the purchasing agent of the Tanter Manufacturing Company discontinued relations with the North Company, and thereafter purchased from the Exeter Company,[1] a wholesale distributor located in a city about 80 miles from the Tanter Manufacturing Company's plant.

In 1924 a salesman of the North Company called frequently upon the purchasing agent of the Tanter Manufacturing Company and attempted to secure orders for wrapping paper by quoting prices slightly below those of any competitor. During 1924 the Tanter Manufacturing Company placed no orders with the North Company, but the persistency with which the salesman called and continued to quote prices below the general market

[1] Fictitious name.

level raised the issue as to whether or not advantage should be taken of the low prices.

Although the purchasing agent believed that he should effect every economy possible for the Tanter Manufacturing Company, he hesitated to give orders at prices which involved no profit, or a loss, to the supplier. The paper supplied by the Exeter Company had been satisfactory during the three years that it had been used. The Exeter Company's prices had been about the same as those of its competitors, and its service had been excellent. The purchasing agent believed that not only had the North Company misrepresented the paper it had sold to the Tanter Manufacturing Company prior to 1921, but that it also had taken advantage of its position as the firm's only supplier and had quoted prices above the competitive level.

If the Tanter Manufacturing Company obtained a part of its requirements from the North Company, it would be assured of more than one source of supply. Lower prices would be obtained, at least temporarily, on orders given to the North Company. The purchasing agent was of the opinion that if he placed only small and occasional orders with the North Company that company would continue to offer low prices. After the experience of 1921, the North Company would know that its shipments were being watched and probably would exercise care to live up to its contracts, especially if it received only a minor share of the Tanter Manufacturing Company's orders. For those reasons, the purchasing agent decided to buy wrapping paper from the North Company whenever its price was below the prices of competitors, limiting his orders, however, to 20% of the firm's total requirements.

This plan proved satisfactory during the first half of 1925. The North Company continued to quote prices below the competitive level, evidently hoping to secure a larger share of the Tanter Manufacturing Company's orders. The quality of the paper received met the Tanter Manufacturing Company's specifications, and deliveries were made punctually.

Commentary: The question involved in this case is one of ethics. The North Company abused the confidence of its customers; it cheated. Hence the Tanter Manufacturing Company followed the only respect-

able course open to it and severed business relationships with the North Company.

The conditions under which relations between the two companies were resumed, however, were not greatly to the credit of the Tanter Manufacturing Company. Its action in resuming relations indicates that its code of ethics was not greatly superior to that of the North Company.

In quoting low prices to regain favor, the North Company manifested no contrition. It had been caught cheating but apparently was complacently confident that sooner or later the Tanter Manufacturing Company would yield to the temptingly cut prices. That the concessions made to the Tanter Manufacturing Company probably were being counterbalanced by exactions from trustful customers, not yet disillusioned, did not seem to give concern to either party—nor was there any reason for doubting that the North Company would cheat the Tanter Manufacturing Company again, provided it could avoid detection. The Tanter Manufacturing Company would have manifested a higher standard of ethics if it had not resumed relations with the North Company under the circumstances stated.

This case also illustrates some of the undesirable practices which too frequently accompany a varying price policy.

March, 1926 M. T. C.

Dillaway Company[1]

MANUFACTURER—MACHINERY

Pricing—*Low Quotation to Secure Initial Order from Potential Customer.* A traction company solicited bids on equipment of the type manufactured by this company. The company submitted a bid 10% higher than the price which it would have quoted on a non-competitive basis, but substantially below the price which it estimated would be quoted by any other bidder. It particularly desired to secure this order because of the expectation that the traction company would purchase more equipment in the future.

Pricing—*Determination of Price to Quote in Competitive Bid.* The company, a manufacturer of electrical equipment, was asked by a traction company to submit a bid on equipment for a power plant in competition with bids of other manufacturers. Inasmuch as the traction company might try to reduce the lowest bid submitted by trading, the manufacturing company decided to submit a bid 10% higher than the price which it would have quoted on a non-competitive basis, but substantially below the price which it estimated would be quoted by any other bidder.

(1923)

The Parkersville Traction Company,[1] in 1923, entered into negotiations with the Dillaway Company for the purchase of equipment for a power plant. The Dillaway Company desired to obtain this order because of the expectation that the traction company would extend its operations so as to require more electrical installations in the future.

The Dillaway Company had several customers who bought from it on a non-competitive basis; that is, they purchased their apparatus from the Dillaway Company without asking for bids from other manufacturers. To such customers the company quoted the lowest prices warranted by the comparatively low selling expense on their orders and the volume of business thus secured. The company desired to obtain the Parkersville Traction Company's order on that basis and was prepared to make a non-competitive bid of $38,000 for the job. The officials of the traction company were informed that the Dillaway Company was prepared to submit a bid and that if the bid were

[1] Fictitious name.

non-competitive it would be as low as possible. The officials of the traction company, however, desired to let the contract on a competitive basis and sent specifications to the competitors of the Dillaway Company.

From its knowledge of the situation of competitors in regard to power-plant equipment, the Dillaway Company estimated that the lowest bid which would be submitted would be $45,000. Inasmuch as it did not know whether the contract would be awarded at once to the lowest bidder or whether the traction company would try to reduce the price by trading, the Dillaway Company proposed to set a price which would secure the order in either case; it wished to make as large a profit as possible without having its original bid appear excessively high if it should have to be reduced. The company decided to submit a bid 10% higher than it would have submitted had the order been non-competitive. It therefore submitted a bid of $41,800. This bid was accepted by the traction company.

COMMENTARY: The significant point in this case is the implied importance of securing an initial order for equipment of this type, because of the advantage that thereby is gained for obtaining subsequent orders from the same customer. Familiarity with the operations of a particular type of equipment and the advantages of standardization in installations within a single plant or group of plants operated by a company cause a predilection for the make already installed, provided it is showing satisfactory performance.

The method of arriving at the price to be quoted affords an interesting example of the trading methods utilized by a non-marginal producer in a competitive field where each sale is an individualized transaction.

December, 1925 M. T. C.

Ellsworth Company[1]

SELLING AGENT—TEXTILES

Price Maintenance—*Customer's Complaint Against Price-Cutting.* The company, which acted as selling agent for manufacturers of textiles, granted a special discount to one of its large wholesale customers. That customer quoted lower prices on the company's merchandise to retailers than were quoted by other wholesalers purchasing from the company. Another wholesale customer complained of this price-cutting and the company contemplated discontinuing the special discount.

Pricing—*Discontinuance of Special Discount to Prevent Establishment of Private Brands.* A wholesale customer of this firm of mill selling agents was endeavoring to establish its private brands. As a means of stimulating sales of its own brands, the customer used well-known manufacturers' brands as price leaders. It was assisted in this by the fact that the selling agent allowed it a special discount because of its large purchases. Because of this customer's persistent price-cutting, the selling agent contemplated discontinuing the special discount.

(1922)

In October, 1922, the Ellsworth Company, a firm of mill selling agents, received a complaint from the Lenox Company,[1] one of its wholesale customers, to the effect that another wholesaler, the Royal Dry Goods Company,[1] had offered retailers the Ellsworth Company's middy twill cloth at the same price that the Ellsworth Company had quoted to the Lenox Company.

The Ellsworth Company's usual terms of sale were 2%, 10 days, net 60 days to wholesalers, and wholesalers in turn usually granted 1%, 10 days, net 30 days to retailers. The Ellsworth Company, however, allowed the Royal Dry Goods Company a special discount of 2½% because of that customer's large purchases of wide sheetings, ticking, khaki cloth, cretonnes, and bedspreads. Under pressure from the buyer for the Royal Dry Goods Company, the Ellsworth Company had been induced to grant this discount also on other types of cloth, such as bleached middy twill. The Lenox Company purchased more than 10 times as much middy cloth from the Ellsworth Company as did the Royal Dry Goods Company, but the Lenox Company's

[1] Fictitious name.

total purchases from the Ellsworth Company were small in proportion to the total purchases of the Royal Dry Goods Company from that source. When the Lenox Company learned that its customers were being quoted the same price on middy twill that it was paying, it immediately made a complaint to the Ellsworth Company and asked for the special discount granted the Royal Dry Goods Company. The Ellsworth Company thereupon suggested to the Royal Dry Goods Company that it cease cutting prices. The wholesaler, however, refused to comply with this suggestion.

The buyers for the various departments of the Royal Dry Goods Company were held responsible for profits and each buyer largely determined his own policies. The buyer with whom the Ellsworth Company had been dealing in this instance commonly had followed a practice of reducing the suggested or usual resale prices on well-known brands of cloth and using these brands as leaders to stimulate sales of more profitable lines of merchandise, usually the Royal Dry Goods Company's own brands. Although this practice was not in accord with the general policy of the Royal Dry Goods Company, it seemed likely that as long as that buyer was employed he would continue to cut prices on leading brands.

The conflict between manufacturers' brands and wholesalers' brands was another cause for contention between the Ellsworth Company and the Royal Dry Goods Company. The manufacturers for whom the Ellsworth Company acted as selling agent had endeavored to establish the popularity of their brands among consumers and, as that popularity increased, had reduced the gross margins allowed wholesalers. The wholesalers, on the other hand, had endeavored to combat manufacturers' brands by purchasing merchandise which bore their own brands, on which they were able to secure higher margins. The Royal Dry Goods Company had undertaken to develop its own brands.

Several years preceding the experience with the cutting of prices on the middy cloth, the Royal Dry Goods Company had introduced its own brand of cretonnes, which had been manufactured in accordance with its specifications. In offering these fabrics to retailers, the Royal Dry Goods Company had listed the prices of the brands sold by the Ellsworth Company beside those

of its own brands, thus intimating that both were of the same quality. Later the Royal Dry Goods Company had sold no cretonnes except under its own brands, and the Ellsworth Company had been obliged to rely wholly upon other outlets for its merchandise of that type.

In a more recent instance, the Royal Dry Goods Company had offered a private brand of sheeting, manufactured in accordance with its directions, which was of a slightly poorer quality than the brand sold by the Ellsworth Company. The prices of the two had been quoted together for a time, and then the brand sold by the Ellsworth Company had been discontinued. Shortly thereafter the Royal Dry Goods Company had introduced a new line of bedspreads under the same private brand name that it previously had placed on bedspreads purchased from the Ellsworth Company. These experiences indicated to the Ellsworth Company that the Royal Dry Goods Company was using manufacturers' established brands to aid in the development of its own brands.

The Ellsworth Company realized that a refusal to continue to grant the special discount to the Royal Dry Goods Company was likely to curb price-cutting, but that such a refusal might also result in the loss of the entire patronage of that customer. The expense of selling to this large wholesale firm was low and no credit risk was involved. On the other hand, the severance of relations with the large wholesale firm would render the Ellsworth Company less dependent upon a single customer.

Commentary: The Ellsworth Company should have expected the friction which resulted from price-cutting by the Royal Dry Goods Company. In granting the special discount, the Ellsworth Company was following a varying price policy; it showed favoritism to a single large customer. The effect was to undermine its market among less favored customers and thus to make it more and more dependent on the large, favored customer. That favored customer, however, was manifesting an intent to take advantage of every opportunity to attain a dominating position by supplanting manufacturers' brands with its private brands, with a view presumably to securing further price concessions from manufacturers dependent upon its patronage.

The Ellsworth Company would have strengthened its position by adhering to a one-price policy. It was improbable, furthermore, that

the Royal Dry Goods Company would have discontinued purchasing manufacturers' brands sold by the Ellsworth Company any more rapidly if the special discount had been withdrawn than if it had been continued. The wholesale firm was proceeding as expeditiously as possible to strengthen its own brands. In fact, the very use of the Ellsworth Company's brand of middy cloth as a price leader was for the purpose of stimulating sales of the wholesale company's brands of other fabrics. Thus, the discriminatory discount was being utilized directly and indirectly to the disadvantage of the grantor. The Ellsworth Company, however, had no logical ground on which to remonstrate against price-cutting by its customer, for the granting of the special discount in itself constituted price-cutting.

This case serves to illustrate the danger of disruptive price-cutting which is likely to result from a varying price policy.

November, 1925 M. T. C.

Dennison Manufacturing Company

MANUFACTURER—PAPER PRODUCTS

Discounts—*Use of Previous Year's Purchases as Basis for Quantity Discounts.* The company, which manufactured a wide variety of paper products, sold the items which it produced for stock to wholesalers and also directly to retailers. The size of the discount allowed a wholesaler or a retailer on purchases of those items depended upon the amount of the buyer's total annual purchases from the company in the previous calendar year. This system of discounts was not wholly satisfactory, and the company contemplated changing it.

(1919)

This problem on the rearrangement of the discounts granted to customers came before the Dennison Manufacturing Company in 1919 for decision.

The Dennison Manufacturing Company's sales headquarters and plant were located in New England. Branch sales offices were maintained in about 30 large cities in the United States, Canada, South America, England, and Denmark. In addition, retail stores were maintained in four large cities in the United States. These retail stores were established primarily for promotional purposes and did not compete to any substantial degree with the independent retail stores which sold the company's products.

The company manufactured a varied list of paper products, such as shipping tags, marking tags, gummed labels, crêpe paper products, jewelers' cases, boxes, and findings. Although the company sold a large quantity of special goods directly to industrial users, this problem was concerned only with its regular stock goods. In these regular stock goods there were approximately 8,000 items. Most of these items were used by the ultimate consumer in small quantities, and the unit price was small. Consequently, they were distributed largely through wholesalers and retailers.

These stock lines were cataloged and priced by the unit or by the carton, which contained 6, 10, 12, or more units. The retail prices given in the company's catalog quite generally were observed by retailers except in the Far West, where high freight

rates made it necessary to charge higher retail prices. The intention of the company was that consumers who bought from retail merchants should pay the prices stated in the catalog. When the goods were boxed in cartons containing more than one unit, the price stated for the carton was called the list price, and the consumer purchasing a whole carton was given this list price by the retailer. When goods were sold in less than carton lots, the unit price was slightly higher than the price per unit in carton lots. From the retail list prices or carton prices the discounts to the trade were figured.

A wholesale stationer, who could carry stocks of practically everything that the company made, received a discount of 40% from the list price, provided he had bought, at net invoice prices, not less than $200 worth of the company's merchandise in the previous calendar year. Under stipulated conditions the wholesaler received in addition specified quantity discounts. The minimum of $200 was a nominal amount and was established merely as a guaranty of good faith on the part of the wholesaler.

The company made a large portion of its sales of stock goods directly to retailers through its traveling salesmen. A substantial number of these retailers also carried on a wholesale business and sold to smaller retailers.

A retailer who had purchased, at net invoice prices, $500 or more worth of the company's products in the previous calendar year received a discount of 40%, the same as a wholesaler. To those retailers buying less than $500 per year, a discount of 30% from the list price was given. Under specified circumstances a retailer, as well as a wholesaler, received quantity discounts, regardless of the annual purchases. Two-thirds of the sales of stock goods were made to retailers who received the 40% discount. Of 10,000 retailers who carried Dennison goods, more than 2,000 were in the 40% class, with annual purchases per retailer of about $1,500.

The company's salesmen called on retailers in cities which had populations of 25,000 or more. All the goods sold by these salesmen were shipped from the company's factory, and the buyers paid the freight. Small, incidental purchases by retailers in these cities, however, usually were made from wholesalers because of the saving in freight.

Numerous objections had been raised to the company's discount plan. In the first place, it had been suggested that there was an element of unfairness in having the amount of the dealer's profit depend on the quantity of goods which he bought from the company. Nevertheless, the minimum requirement of $200 per year for each wholesaler and $500 for each retailer was well within the reach of those merchants who took sufficient interest in the Dennison line to give it adequate display and promotive attention.

While it was the company's intention immediately to increase the discount when a wholesaler or a retailer reached the minimum requirement, it was often difficult, with 10,000 accounts, to put the increased discount into effect as soon as the merchant was entitled to it. If the company failed to make this change at once, its oversight was resented by the merchant.

There also were frequent occasions on which a merchant reached $500 in purchases in one year only to fall below that amount the next year, thereby reducing his discount in the third year. After a retailer was once placed in the $500 class, he remained there until for one calendar year he had fallen below that limit. Reductions in the discount, however, were fairly frequent, because of the fluctuations in a merchant's business and also because a merchant might reach the minimum in one year as a result of an unusually large order for Dennison goods received from one of his customers, as, for example, from a government agency or from a railroad company.

One object of the high discount was to reward the merchants who took an interest in this line, and it was advantageous from one standpoint to hold forth the inducement of the high discount as an incentive to the merchants who had not yet attained it. It had been found, however, that this stimulus tended to encourage merchants just under the line to pad their orders near the end of the year in order to go over the $500 mark. If orders were padded in one year, the merchants ran the risk of purchasing less merchandise from the company the next year, and thus might subsequently fall below the minimum amount and become discontented.

Friction also was encountered with the merchants who failed to reach the minimum by only a few dollars and who claimed that an injustice was being done to them when they were so near

the mark and yet did not receive the large discount. This difficulty had been particularly pronounced during periods of unusually heavy demand and shortage of many items. Under those conditions the company frequently had been unable to ship to merchants all the goods they ordered. Consequently, the merchants had claimed that if the company had made shipments to them in accordance with their orders, they would have been well over the $500 line.

The company was embarrassed also when it opened accounts with new customers who prospectively had 40% accounts, either because they already had large established businesses or because they were starting businesses of their own on an unusually large scale after having acquired experience elsewhere. Such merchants believed themselves entitled to the 40% discount because of the future possibilities of their businesses. In many of those cases the company would prefer to give the new customers as great an inducement as possible to put in a full line of Dennison goods, provided it could be done without breaking down the established policy.

In the few years prior to 1919 there had been a rapid advance in prices, and $500 worth of merchandise represented much less in bulk than it did in 1914. Consequently, many retailers were coming into the 40% class. If prices and the volume of sales returned to a more normal level, several of those merchants would drop back into the lower class.

The company also was troubled from time to time with the pooling of orders whereby two or more small retailers entitled only to 30% discount combined in ordering their goods so as to reach the $500 mark. The company could not stop this abuse, provided the goods were shipped and billed to one address. It did decline to grant the discount if the retailers asked to have the goods shipped or billed to more than one address.

One of the suggestions that was made for the solution of this problem was to give all customers, both wholesalers and retailers, the discount of 40%. This would be objected to by wholesalers as cutting off their patronage from the small retailers. The wholesalers were selling to small stores in urban districts and especially to stores in rural districts and small towns.

Another suggestion was to eliminate the minimum purchases

requirements, to give retailers 40% off, and to give an extra 10% discount to wholesalers. One of the drawbacks to this plan was that numerous retailers also were wholesalers. They immediately would claim the extra discount, and it would not be long before other large retailers would demand the same discount as their competitors. The company was apprehensive, furthermore, that the introduction of the extra 10% discount to wholesalers who were also retailers would result in price-cutting.

COMMENTARY: In this case the major question was whether to continue to grant a higher discount to retailers whose purchases annually amounted to more than $500 each than to retailers whose purchases were less than that amount. Inasmuch as a large portion of the company's sales of stock goods were on orders received directly from retailers, with more than 2,000 retailers receiving the same rate of discount as that granted to wholesalers, the problem of affording protection to the wholesalers was not a primary issue in this case. Attention can be directed chiefly, therefore, to the company's relations with retailers.

The discount of 30% from the retail list price, granted to retailers who purchased annually less than $500 each, was an ordinary trade discount, intended to provide the retailers with a normal gross margin. The extra 10% discount allowed to retailers whose yearly purchases equaled or exceeded $500 each was in effect a premium for maintaining a specified volume of purchases. It might be termed a patronage discount. This extra discount differed from an ordinary quantity discount in that it was based on annual purchases, not on the size of individual orders. Unlike an ordinary quantity discount, the extra discount offered in this case was not warranted by specific savings in handling particular orders, but by the effect which it was presumed to have upon the company's aggregate volume of sales.

The difficulties of administering this type of patronage discount are indicated in the statement of the company's experiences—the friction with customers just under the line, the antagonism aroused by the withdrawal of the discount once granted, the padding of orders, and the trouble arising because the discount was based on past, not current, performance. These difficulties were inherent in this type of discount.

The advantages to the company from the employment of the patronage discount lay in its stimulus to continuous patronage and in its encouragement to retailers to feature Dennison goods. It is stated that more than 2,000 retailers were in the 40% class, with average purchases per retailer of about $1,500 a year. Thus the aggregate

annual sales to retailers who received the 40% discount must have been approximately $3,000,000. The extra 10% discount on that sum amounted to about $300,000 a year. Except for the discount on the merchandise bought by some of these retailers for resale at wholesale, the foregoing amount of $300,000 represents the sum which the company was allowing to retailers for their sales promotion assistance on Dennison goods. It is doubtful if the benefit gained was commensurate with this grant; at least the question fairly may be raised as to whether the expenditure of an equivalent amount in advertising to consumers would not have yielded greater returns.

The proposal to give all retailers a flat 40% discount and wholesalers an extra 10% would not have improved the situation. Since numerous firms sold both at wholesale and at retail, the company soon would have found itself granting discounts to retailers of 40% and 50% instead of 30% and 40%, without having solved the basic problem.

The suggestion that the company grant a flat discount to all customers had more merit. Whether that discount should have been 30%, 35%, or 40% it is impossible to judge from the data furnished. The chief argument in favor of the 40% rate was that the use of that rate would have avoided arousing the antagonism that would have ensued from a lowering of the rate of discount to customers who already were enjoying the 40% rate.

Under the circumstances in this case, in order for a flat trade discount to have worked satisfactorily, it would have been necessary to supplement it by quantity discounts on individual orders graduated on a scale fully commensurate with the savings to be effected. The company already was granting some quantity discounts, but apparently they were of minor consequence. It is conceivable that by use of an adequate system of quantity discounts it would have been possible to reduce the flat rate of trade discount to 35%, perhaps to 30%, without antagonizing the large customers. Whether or not a satisfactory scale of quantity discounts could have been devised for such a varied line cannot be judged without comprehensive data obtained from an analysis of order records. Whatever scale of quantity discounts was offered to retailers, however, it would have had to stand for the wholesalers also, because of the influence of firms which carried on combined retail and wholesale businesses. A proper scale of quantity discounts, with a minimum order limit, would have accorded the wholesalers as great protection as they received under the existing plan.

The Dennison Company's problem was seriously complicated by the

obstacles to modifying an existing practice without arousing strong hostility. This case has significance for firms which have not adopted a plan of patronage discounts based on yearly sales in that it shows the embarrassments of operating such a plan and the difficulties of extrication.

April, 1926 M. T. C.

National Biscuit Company

MANUFACTURER—BAKERY PRODUCTS

Sales Planning—*Arrangement of Quantity Discounts to Discourage Overstocking.* The size of the quantity discounts which the company, a manufacturer of nationally advertised, semi-perishable bakery products, granted retailers was based on the amount of the retailers' monthly purchases. The scale of discounts was arranged so as to discourage retailers from overstocking, since sale of stale merchandise to consumers would have injured the reputation of the company's brand.

Distribution Channels—*Direct Selling to Protect Reputation of Semi-perishable Products.* A company manufacturing nationally advertised, semi-perishable bakery products sold directly to retailers in order to protect the reputation of its goods by preventing stale merchandise from reaching consumers. For this same reason, the company refused to sell to buying pools of retailers.

(1921-1924)

Complaints brought by retail grocers operating unit stores against the National Biscuit Company's discount policy culminated in an action before the Federal Trade Commission in 1921. The complaint of the commission stated that the policy of the National Biscuit Company in granting quantity discounts discriminated against small unit stores which had entered buying pools in order to obtain maximum discounts, and reacted in favor of chain stores.

The National Biscuit Company maintained an extensive system of wholesale branches and through its salesmen sold directly to retailers. In unit stores the company's salesmen on frequent calls gave advice regarding the quantity to purchase, inspected the quality of stock on hand, arranged for merchandise display and occasionally for window display, and made collections. In the case of sales to a chain store company, the merchandise was delivered to the individual stores, and collections were made either from the stores or from the central office in accordance with receipts signed by the store managers.

Regarding the complaint of the Federal Trade Commission, the company published the following statement, September 9, 1922:

THE FACTS IN THE FEDERAL TRADE COMMISSION COMPLAINT

As is well known, we have a uniform discount policy and we do not depart from it in any particular. There are no exceptions. Our customers, as respects quantity discounts, are divided into four classes:

Class A includes those customers who buy a total of all of our biscuit amounting to $200 or more in a given month. These customers receive a discount of 15%.

Class B includes customers who buy $50 or more in a given month but less than $200. These receive a discount of 10%.

Class C includes customers who purchase $15 or more in a given month but less than $50. These customers receive a 5% discount.

Class D includes those customers who purchase less than $15 of all of our biscuit in a given month, and who receive no quantity discount.

We also give a cash discount. All customers who pay within 10 days receive a discount of 1%.

To us a "customer" is any person, partnership, or corporation owning and operating one or more stores. We do not sell to pools of any kind.

Our products are particularly perishable, in that they begin to deteriorate as to quality, though not as to wholesomeness, within a comparatively short time after manufacture or packing. We aim to place upon the market only the highest class of goods, and, therefore, the first essential of our business is that as brief a period as possible shall elapse between the time one of our products leaves our ovens and the time it reaches the consumer's table. This policy is part of the groundwork of the business and is vital to the maintenance of our well-earned reputation for putting out the finest goods as respects wholesomeness, taste, and general *quality*. Therefore, by reason of the nature of the business, it has been our policy to sell and to deliver direct to retail stores. We place the goods in the stores as quickly as possible, and it is the business of our salesmen, among other things, to make certain that no retailer overstocks and to aid the retailer in every possible way to sell the goods as rapidly as possible. This has the effect of increasing his turnover and, therefore, his profit, and also of building up his business and our own by cultivating among consumers the deserved reputation of supplying only the freshest goods of the best quality.

These basic reasons are the foundation and the origin of our discount policy. In studying the subject and in consulting various customers, we found that a discount policy like that set forth above would be best constituted to promote the business of our customers and, therefore, to make our own business grow and to serve the consuming public.

Any independent retail grocer buying $200 of our goods in a given month obtains a quantity discount of 15%. No customer, not even a chain store having thousands of branches, and buying many, many thousands of dollars of our goods per month, can, nor has any such

buyer or customer ever obtained any concession or allowance or more than this 15% quantity discount, either directly or indirectly.

Under this plan many independent retailers formerly in Class B or C have now by energy and alert business methods and genuine salesmanship built up their businesses to $200 or more per month, thus putting themselves in Class A and obtaining the largest discount that any one can obtain from the National Biscuit Company.

Excluding from the computation all chain stores, even a chain store consisting of but two stores under one ownership, we are regularly selling to a great number of independent retailers throughout the United States who buy $200 or more per month of our products; indeed, the total of these Class A customers, excluding chain stores, is now in the thousands.

The case against us that is now being heard before the Federal Trade Commission is the result of complaint by some retail grocers who desire to join in pools for the purpose of purchasing from our company on a pool basis and by this device attempt to secure a 15% discount as against a 10%, or in some cases the 5% discount they now receive. The Commission's inquiry is directed to the question whether or not our discount policy is an illegal price discrimination against those who do not earn the 15% discount by selling $200 worth or more per month of our products, and whether or not our policy tends to build up chain stores or a proposed chain store monopoly as against independent retailers.

It is difficult to see how we could be justly accused of any favoritism to the chain stores or any discrimination against independent retailers, who constitute by far the greater part of our customers. As to price discrimination, we cannot be said to discriminate in price against retail pools or buying exchanges, because it is the uniform policy of this company not to sell to such pools or combinations *at any price.*

Moreover, retailers in Class B and Class C have testified in our behalf in the present case that they favor our discount policy and that they would not regard it as fair for us to sell to a pool, and thus enable some other independent retail grocers, competitors of theirs, to obtain by the mere device of joining a pool a discount equal to or greater than the discount that such independent retail grocer had obtained by his own sales efforts.

And finally as to the charge of building up chain stores, our company, so far as we know, is the only manufacturer that absolutely refuses special discounts to chain stores by reason of the very large quantities that they sometimes purchase; in other words, the thousands of independent retailers who buy $200 worth or more of crackers per month, as well as the very smallest chain having only two or three or four stores but buying $200 or more per month, obtain exactly the same discount that is received by the largest chain store groups in the United States, some of which purchase in a month from $10,000 to $40,000 or $50,000 or more of biscuit.

The Federal Trade Commission reached a decision in the case of the National Biscuit Company in January, 1924.[1] At that time the commission ordered the company to discontinue its policy of allowing discounts to chain grocery store companies on the total purchases of all their units from the company so long as it refused to allow similar discounts on gross purchases to associations or combinations of independent grocers. Portions of the commission's findings as reported in its decision follow:

Paragraph 6. The respondent allows to purchasers operating more than one retail grocery store, or what are commonly known as "chain stores" (and will be hereinafter so designated), a discount in price on the monthly gross purchases of all the separate units or retail grocery stores of such chain store systems. The number of separate units or retail stores in the various chain store systems vary from two to more than seven thousand. The respondent serves each separate unit or retail store of a chain system as a distinct and separate purchaser—its salesmen solicit and take orders from the managers of each of the separate units or retail stores; it makes deliveries to each separate unit or retail store; in many instances the manager of the separate unit or retail store pays for respondent's goods when they are delivered, but in other instances payment is made at the headquarters of the chain system; in some instances the general manager of the chain store system at headquarters to a certain extent determines the brands or varieties of respondent's products that the separate units or retail stores of such system will carry—that is, the general manager will list the number of brands and varieties that each separate unit or retail store will be allowed to handle—but the managers of the separate units or retail stores then choose any or all of such products on such list that they think they can sell in their respective communities, and the quantities to be purchased by each separate unit or retail store in all instances are determined by the manager of said unit or retail store and given to respondent's salesman when he calls; in some instances, however, the manager of the separate unit or retail store determines the brands or varieties that his store will handle, and has complete charge of the ordering of biscuits and crackers from the respondent. Different units or retail stores of a chain system in many instances handle different brands or varieties of respondent's products.

. . . .

Par. 9. In many instances a purchaser operating a single retail store is in direct competition with a purchaser operating a separate unit or retail grocery store of a chain system in selling respondent's products, and the aggregate monthly purchases of respondent's products by said purchaser operating a separate unit or retail grocery store of

[1] *Federal Trade Commission* v. *National Biscuit Company* (No. 423) Docket 836, January 23, 1924.

the chain system are no greater than the aggregate monthly purchases of respondent's products by the purchaser operating a single retail store; yet the respondent grants a larger discount to the purchaser operating a separate unit or retail grocery store of the chain system than it does to the purchaser operating a single retail store.

. . . .

Par. 14. In order to compete with retail units of chain store systems in selling National Biscuit Company products, groups of independent retailers in many localities in different parts of the United States have attempted to combine their purchases and obtain discounts equal to those granted to the chain stores:

(*a*) In some instances one of the independent retailers would buy for two or three of his neighbors—placing the order, receiving all deliveries at his store, and paying for the goods, the other grocers in the combination calling at his store and getting the goods thus ordered and received by him.

(*b*) In some instances groups of independent retailers have requested the National Biscuit Company to make to them deliveries similar to those it makes to the separate units or retail grocery stores of chain systems; to take orders from them as it takes orders from separate units or retail grocery stores of chain systems; and have offered to pay respondent cash on delivery, or in the same way as the chain stores pay; and have further offered to meet any requirements the respondent makes of the chain systems.

(*c*) In other instances corporations have been formed, in which the stock is owned exclusively by retail grocers. These corporations have requested the National Biscuit Company to sell their stockholders or members on the same terms and in the same manner as said respondent sells separate units or retail grocery stores of chain systems. These corporations have offered cash on delivery for the goods, or to pay for them as the chain stores pay, and to meet every requirement that the National Biscuit Company makes of the chain systems.

. . . .

Par. 23. In many instances, independent retailers purchasing less than $200 per month of National Biscuit Company products (which include approximately 90% of respondent's customers in the United States) are unable to successfully compete with purchasers operating separate units or retail grocery stores of chain systems in the sale of respondent's products, because of the difference in discounts.

Par. 24. In many localities in the different parts of the United States, independent retail grocers who do not carry National Biscuit Company products or who do not sell respondent's products at a price equal to that at which the separate units or retail stores of chain systems are selling such products, not only lose the sale of respondent's products,

but also thereby lose the opportunity of supplying customers with other commodities.

. . . .

Par. 26. That the effect of the application of respondent's system of discounts, as hereinbefore set out, gives to one class of retail grocers an undue advantage in competing with another class of retail grocers in the handling of respondent's products, which has the capacity to and does tend to substantially lessen competition and to create a monopoly in the retail distribution of respondent's products.

In May, 1924, the Circuit Court of Appeals of New York reversed the order of the Federal Trade Commission in the case of the National Biscuit Company.[2] The opinion of the court read in part as follows:

We conclude that the sales policy of the petitioners as to their discount plan, as well as the refusal to sell cooperative or pooling buyers, is fair in all respects as to all its competitors and customers.

This policy obviously does not affect the public interest nor deprive it of anything it desires. It is a practice which is recognized by manufacturers of bakery products and is inoffensive to good business morals. It was error to direct the petitioners to sell to individual grocers who pooled their orders of purchase or who bought on a cooperative basis. While a chain store owner may handle more crackers because of his ownership of more than one store, this is but the result of healthy competition.

A manufacturer of biscuits cannot be expected to adopt a uniform policy that is appropriate to meet the small buyer and the large buyer. There is no discrimination between the large buyer such as the owner of a chain store, and the grocer owning but one store. There is evidence in the record that many individual grocers do a large enough business to win the discount provided for under the petitioners' policies.

A pool is organized merely to buy and not for selling purposes. The manager of the pool, when it has a manager, merely buys as an agent or employee of the pool. He has no control over any of the various grocers in the pool. He incurs no financial liability. Each member of the pool controls his own business and is liable for his own indebtedness.

The case is different where the sale is made direct to the manager of a chain unit. By pooling purchases, the retail customers of the petitioners would afford no service in the sale of the petitioners' product to the consumers beyond that which each furnishes individually, and it may be noted that the advertising of the large chain stores inures to the benefit of the petitioners' products by creating a wide-spread and uniform demand for their products and consequently larger sales.

---

[2] *National Biscuit Company* v. *Federal Trade Commission,* 299 F 733. See also, 45 S. Ct. 95.

Commentary: As this case was presented to the court, it is difficult to see how a different decision could have been reached. The effort to force the company to sell to pools or group buying organizations was not well advised, for sale and delivery direct to retail stores were an integral part of the company's sales plan whereby it guarded against delays in delivery resulting from rehandling and against the danger of the accumulation of stocks of stale goods on retailers' shelves. The merchandise was semi-perishable, and the company could maintain and enhance the reputation of its brand only by regulating carefully the distribution to retail stores. If, instead of attempting to force the company to sell to pools and buying associations, the opponents of the company's policy had concentrated attention on a demand that the discounts granted to each store operated by a chain store company be determined by the purchases of that store rather than by the aggregate purchases of the parent company, the court might have reached a different conclusion. When the company dealt with each chain store manager independently, it is not clear that the discounts to the store should have been on a basis different from that which determined the discounts to independent unit stores. With such a low limit—purchases of $200 a month—constituting the qualification for the maximum discount, however, it is hardly worth while to speculate at length on that question of alleged discrimination.

Quite aside from its legal aspects, the case presents an especially interesting example of the use of quantity discounts based on monthly purchases.

As in the Dennison Manufacturing Company case,[3] discounts determined by the quantity of goods bought during a specified period were used by this company to encourage continuity of patronage and to aid in sales promotion. The National Biscuit Company had particularly strong reasons for the use of such discounts. Its products were semi-perishable; hence the risk of encouraging retailers to overbuy on individual orders, as might have resulted from quantity discounts based on individual orders, was to be avoided. The period discounts were preferable to quantity discounts on individual orders. The products could not be manufactured for stock, because of their perishable nature. As a result of the stimulation of continuity and regularity of patronage among many customers, it is probable that factory operations were rendered more regular and more economical.

The company's products had a continuous sale in the retail stores and a sufficient potential sales volume in each store to warrant the use of monthly purchases rather than annual or semiannual purchases as the basis for determining the discounts. The monthly basis was con-

[3] See page 407.

sistent with the company's sales and production plans, equitable to the retailers in general, and a constant stimulant to sales promotion. By using the monthly basis, furthermore, the company avoided some of the difficulties inherent in a yearly plan of period discounts. The success of the monthly plan, however, was conditional upon the rapid rate of stock-turn of the semiperishable goods in the retail stores, from which a high frequency of purchase resulted. The plan was especially suited to this type of business but could not have been expected to operate satisfactorily in many other types of industry.

April, 1926. M. T. C.

Hunt Insulated Wire Company[1]

MANUFACTURER—INSULATED WIRE

Discounts—*Use of Trade Discounts as Means of Facilitating Distribution through Wholesalers.* The company, which manufactured insulated wire, cord, and cable, sold directly to large users but preferred not to sell directly to retailers or small users because it wished to avoid antagonizing wholesalers selling its merchandise. The scale of trade discounts which the company used was designed to encourage retailers and small users to purchase its merchandise from wholesalers. In planning to introduce an improved type of wire, the company had to decide whether to apply the established scale of discounts.

(1922)

The Hunt Insulated Wire Company, in May, 1922, was planning to put on the market an improved type of rubber-covered electrical cord for household and general industrial uses. It was necessary for the company to decide whether to apply its usual system of trade discounts to that item. The company's engineers had been engaged for two years in perfecting machinery for the quantity production of the improved cord, which was asserted to have several advantages over ordinary electrical cords and cables with braided insulation. Although the new product was not patented, the company expected that competitors could not duplicate it successfully in less than a year.[2]

The company normally employed about 525 men in its manufacturing plant. Its sales in 1921 were $4,125,000. In the previous year total sales had been in excess of $5,250,000. The products of this firm comprised various types of insulated wire, cord, and cable for outside use, both underground and overhead, and also for equipment in mines, manufacturing plants, and buildings of all types. The company made everything in its line from a simple type of insulated cord for use on lamps and other household electrical appliances, retailing at 5 or 6 cents a foot, to heavily armored submarine cables selling at $5 or $6 a foot. Electric light and power companies, street railways, manufactur-

[1] Fictitious name.

[2] Methods used by the company in obtaining rapid initial distribution of this new product are brought out in Hunt Insulated Wire Company, 1 H.B.R. 339; commentary, 2 H.B.R. 500.

ing establishments, and mines constituted a large part of the company's market. Sales also were made to contractors for the wiring of large buildings. Those of the company's products that were used in private houses and small industrial plants were sold by retail dealers, including contractor-dealers and central power stations, as well as by electrical specialty stores.

The Hunt Insulated Wire Company sold directly to electric light and power companies, street railways, large manufacturing plants, mines, and other customers who purchased in large quantities. In many instances this business was on a keenly competitive basis, and bids ordinarily were submitted by several large manufacturers of electrical goods. Sometimes these goods were purchased by manufacturers to be used as part of their own products; a large producer of vacuum cleaners, in a typical instance, asked several wire and cable companies to submit bids for 1,000,000 feet of cord for use on vacuum cleaners. Wholesalers as well as manufacturers frequently were asked to submit bids on large orders of wire and cable. Under such circumstances a wholesaler usually consulted manufacturers to learn which one would give him the best price, and then submitted a bid based on that figure.

Although occasionally the Hunt Insulated Wire Company made sales directly to contractor-dealers and small industrial establishments, it preferred that orders for merchandise to be sold at retail should be filled by wholesalers. Electric light and power companies which were purchasing large quantities of wire and cable directly from the company for installations not infrequently had complained because the company would not sell its smaller items, principally for use in homes and small machine shops, directly to the central power stations. This the company had been unwilling to do for fear of antagonizing wholesalers; it believed that it was dependent upon wholesalers for the bulk of its sales in these small items.

Electrical wholesalers commonly sold all varieties of electrical equipment for household use, including wire, cord, electric lighting fixtures, bulbs, sockets, washing machines, vacuum cleaners, toasters, curling-irons, heaters, flat-irons, radio apparatus, and the like. The wholesalers usually secured a wider margin of profit on household appliances than on wiring and fixtures. Specialty wholesalers, such as mining supply firms, handled supplies and

equipment for specific industries exclusively. Both classes of wholesalers carried stocks and in general performed the usual wholesale functions. Occasionally the company gave a wholesaler exclusive privileges for the distribution of a few items in a restricted territory. In those instances, however, the company reserved the right to sell directly to large purchasers within a wholesaler's exclusive territory without giving the wholesaler a commission on those sales.

The company had sales offices in Chicago, New York, Boston, Salt Lake City, and San Francisco. From four to six salesmen, paid on a straight salary basis, worked from each of these offices. A large part of their time was given to missionary and general sales promotion work. In territories at long distances from the company's sales offices, extensive use had been made of manufacturers' agents, each of whom ordinarily represented several non-competing companies. Such an agent had an exclusive territory and handled the full line of the company's products, while wholesalers usually handled only a portion of the line. These agents acted as order-takers; they carried no stock and assumed no credit risk. The company paid a commission of from 5% to 10%, depending upon the article, on all sales made by such agents; commissions were paid when the company received payment. An agent received commissions on all sales made in his territory whether or not he assisted in securing the orders.

Although the company was forced to take losses on inventories of raw materials during the decline of prices in 1920 and 1921, when this problem arose in 1922 it had ample stocks of rubber and copper purchased at prices somewhat below the prevailing market figures. List prices of the company's products included freight to destination and were subject to the following discounts:

DISCOUNTS TO CONSUMERS

Under	350 feet	net
350 to	1,500 feet	5%
1,500 to	5,000 feet	10%
Over	5,000 feet	20%

DISCOUNTS TO CONTRACTOR-DEALERS

Under	350 feet	15%
350 to	1,500 feet	10% and 10%
1,500 to	5,000 feet	20% and 10%
Over	5,000 feet	25% and 10%

DISCOUNTS TO WHOLESALERS

Under	350 feet	15% and 5%
350 to	1,500 feet	10%, 10%, and 10%
1,500 to	5,000 feet	20%, 10%, and 10%
5,000 to	25,000 feet	25%, 10%, and 10%
Over	25,000 feet	25%, 10%, 10%, and 5%

Extensive tests which had been made of the new rubber-covered cord had shown it to be more durable than the ordinary type with braided insulation. The principal feature was a reinforced construction of alternate layers of rubber and fabric, similar to the construction of an automobile tire. In one machine-shop, where small cords of this kind were used to supply current to portable electrical drills, the new rubber-covered type had outlasted two of the braided cords and had shown no perceptible wear. For experimental purposes, the company had made a cable of the same construction for use in bituminous coal mines that employed electrical mining machinery. In a test made in a West Virginia mine this new cable and several others, including those of competitors as well as those made by the Hunt Insulated Wire Company, were run over by a mine locomotive. While the insulation of all the other cables was entirely torn away by the locomotive wheels, there was scarcely an injury to the rubber-covered cable. The company intended to conduct further experiments with larger cables of this construction. At the outset, however, the cable was being produced chiefly in small sizes which the company expected could be sold at prices but little higher than those of directly competing products.

COMMENTARY: The new type of wire which the company was placing on the market was to be sold both as a fabricating material and as an operating supply. Large purchasers of wire for fabricating purposes commonly placed their orders directly on the basis of competitive bids, and no issue was raised in this case regarding the determination of prices for those competitive bids. For the distribution of wire sold for supply purposes and to small fabricators, the company deemed the services of wholesalers and supply merchants to be essential. Hence, the system of trade discounts adopted by the company was aimed at protection of the wholesalers. This protection was afforded not only by a scale of quantity discounts but also by an actual differential on equal quantities. The company did not refuse to sell to small industrial users or to contractor-dealers, but it did not grant them as large discounts

as it granted to wholesalers, and it did not grant users as large discounts as it granted to contractor-dealers. The chief effect of this discount plan must have been to encourage users and contractor-dealers to buy from wholesalers. The discount plan was conducive, therefore, to the realization of the company's merchandising objectives.

April, 1926 M. T. C.

Damariscotta Company[1]

WHOLESALER—HARDWARE

Discounts—*Use of Trade Discounts as Means of Facilitating Price Changes.* The company, a wholesale hardware firm, issued catalogs containing list prices to retailers once each two or three years. From the prices given in those catalogs, the company's salesmen were authorized to quote various sets of discounts to retailers. Because this system of list prices less a series of trade discounts facilitated price changes, which occurred much oftener than a new catalog economically could be issued, the company was unwilling to quote net prices in its catalogs.

(1922)

The Damariscotta Company of Chicago was a wholesale hardware firm. Its salesmen regularly visited all parts of the United States except New England. In 1922 the company carried more than 50,000 different articles in stock, and on most of its lines there was severe price competition. Once each two or three years the company issued a new catalog, which contained from 2,000 to 2,500 pages. Opposite each item was a list price from which, according to a notice at the beginning of the catalog, retailers were entitled to a discount of approximately 50%. In practice the prices actually paid by retailers were neither the list prices nor the list prices less 50%.

The company's salesmen were provided with loose-leaf price-lists in which were given three sets of discounts for each item or group of items. The first set of discounts yielded for each article a net price which was equal to cost plus handling charges. The next set of discounts yielded a higher net price, which was known as the "inside" price. The third set of discounts was the lowest and the resultant price was called the "outside" price. These discounts were in code. In addition, there was what was known as the full package price on selected goods, which was lower than the "inside" price. New price sheets were furnished to salesmen as price changes were made. The system of list prices less a series of trade discounts was used to facilitate changes in the prices of articles, such as bolts and screws, on which there often were as many as 18 or 20 changes in a year.

[1] Fictitious name.

Salesmen used their own judgment in quoting prices to retailers. Large buyers frequently were able to obtain the "inside" price; others in the course of bargaining eventually secured prices somewhere between the "inside" price and the "outside" price. In cases where the credit risk was high, the salesmen ordinarily were instructed to insist on the "outside" price. In order to discourage salesmen from quoting prices too near the cost of merchandise plus handling charges, the Damariscotta Company had adopted a plan of compensation whereby the salesmen's remuneration depended partly on the margin between the price which represented cost plus handling charges and the price actually obtained.

Whereas formerly prices of many goods in the hardware trade had been quoted on a pound or square-foot basis, the Damariscotta Company quoted all prices on the ordinary sales units or multiples thereof. The company's usual terms of sale were 2% for cash in 10 days, net 60 days; interest at the rate of 6% per annum was charged on overdue accounts. Accounts outstanding usually represented about 40 days' sales. Prices were quoted f.o.b. Chicago, except in special cases where competition made it necessary to equalize freight charges. The company endeavored to secure an average gross profit of 20% on sales. In normal years the operating expenses of the company had been from 17% to 18% of net sales, and the rate of stock-turn had been 3½ to 4 times a year.

The use of list price catalogs and trade discounts was common in the wholesale hardware trade. Several wholesale firms, however, issued catalogs in which net prices were quoted to retailers, and this had led retail hardware merchants to request that other wholesalers adopt the net price plan in their catalogs.

The practical difficulties to be overcome in issuing a net price catalog had appeared insuperable to the Damariscotta Company. The catalog was large. When bound, the expense of preparation made it imperative that each edition remain in use for at least two or three years. Price changes were frequent; it was necessary that they be made much more frequently than a new catalog economically could be issued. A loose-leaf catalog often was not utilized properly by a retailer, and it was expensive for a wholesaler. The Damariscotta Company believed that it would lose

ground to competitors if it were to issue a net price catalog; the competitors would learn its prices immediately and then cut them.

COMMENTARY: The list prices used by this company were merely points from which to start the computation of net prices. The list prices did not represent the standard retail prices, as in the Dennison Manufacturing Company's plan,[2] or the wholesale prices, as in the Mennen Company's plan,[3] or prices quoted to unprotected customers for small purchases, as in the Hunt Insulated Wire Company's plan.[4] The list prices as used by the Damariscotta Company were solely tools for the computation of net prices.

The system of list prices and trade discounts was used by this company partly because of the manner in which it facilitated the changing of prices when costs or market conditions changed. The net prices of a whole series of products, as for example wood screws of various sizes, could be altered by the change of a single discount rate. When the same discount rates applied to a group of items or range of sizes, the salesman's price-list could be condensed and rendered more convenient for use.

If net prices had been quoted in the catalog, it would have been necessary to change the catalog, either in whole or in part, whenever a price change occurred. A customer customarily assumes that a net price quoted in a catalog remains in effect during the normal life of the catalog, unless notified effectively to the contrary. This company had 50,000 items listed in its catalog, with from 20 to 25 items to a page. If a loose-leaf catalog had been attempted, the task of reprinting whole pages in order to notify customers of a change in the price of a single item would have been burdensome. A much more serious objection to a loose-leaf catalog lay in the possibilities of confusion and errors arising from the failure of customers to replace old leaves, in a 2,000-page catalog, with new leaves on which corrected prices were published.

The utilization of such a trade discount plan involved more clerical labor in billing than would have been required had the company quoted net prices. A heavier task also was imposed on the retailers who purchased from the company, since more labor was necessary for verifying invoices for merchandise which bore trade discounts than for goods bought at net prices. Despite these disadvantages, however, the use of trade discounts probably was warranted in such a business as this. The method in use facilitated the notification of salesmen regarding

[2] See page 407.

[3] Mennen Company *v.* Federal Trade Commission, 1 H.B.R. 287.

[4] See page 422.

price changes. It also avoided the confusion which would have arisen if net prices had been published in the catalog which did not hold good for the life of the catalog.

The practice of varying trade discounts between customers of the same class who purchased equal quantities of any particular item had the effect of varying net prices and was subject to the same criticism which was directed against the practice of varying prices by the Windermere Dry Goods Company.[5]

April, 1926 M. T. C.

[5] See page 392.

Rickel Shoe Supplies Company[1]

MANUFACTURER—SHOE FINDINGS

Pricing—*One-Price Policy Facilitated by Quantity Discounts.* The company, which manufactured shoe findings, had followed a one-price policy, granting no quantity discounts, until competition had necessitated price concessions to various large purchasers. When this situation arose, the company decided to adopt a scale of prices under which prices were comparatively less for large unit purchases than for small, and to offer this same scale of prices to all customers.

(1922-1924)

The Rickel Shoe Supplies Company manufactured several thousand items, which it classified in two main groups. One group included supplies, and had two subdivisions: machine supplies, which comprised articles such as brushes used on machines for the manufacture and repair of shoes; and findings such as eyelets, nails, and wire, which became a part of the shoes. The other group included tools such as hammers, dies, and cutters. The articles which the company manufactured were standardized; all shoe factories and repairers purchased tools and other findings of a similar nature. The company's annual sales amounted to more than $1,000,000. Eighty per cent of the sales were of items in the supplies group and 20% were of tools.

The sizes of individual orders which the company received, as well as the amounts of its annual sales to individual customers, showed wide variations. Prior to 1921 the company had quoted the same prices to all customers regardless of the quantities which they purchased. In that year, in order to meet competition, the company had made price concessions to various large purchasers. In 1922 the company considered the advisability of changing its price policy to allow for variations in prices on the basis of quantities purchased.

The company made 80% of its sales to shoe manufacturers; 15% to findings wholesalers for resale to shoe repairers; and 5% to producers of shoe manufacturing or repairing machinery. Most of the company's sales to manufacturers of shoes and of shoe machinery were made directly, but most sales to the repair

[1] Fictitious name.

trade were made indirectly through findings wholesalers. Shoe manufacturers, however, sometimes purchased from wholesalers in order to obtain better service than manufacturers offered, and the company also sold certain items directly to shoe repairers, although it encouraged these purchasers to buy from the findings wholesalers. Approximately 600 shoe manufacturers and 450 findings wholesalers had accounts with the Rickel Shoe Supplies Company.

The sizes of orders received from shoe manufacturers varied greatly, depending upon shoe styles, the season of the year, and prosperity in the shoe industry. Many large shoe manufacturers purchased their supplies in accordance with a daily production program. It was the company's experience that the average annual purchases of a typical shoe manufacturer were about the same as those of a typical wholesaler, but that the largest annual purchases made by a shoe manufacturer were more than 10 times the largest annual purchases made by a wholesaler.

About 80% of the sales of findings wholesalers were of leather heels and rubber heels. As far as the company could ascertain, the wholesalers turned their stocks approximately 12 times per year, and their costs of doing business amounted to from 20% to 25% of their net sales. They carried from one to two months' stock of the Rickel Shoe Supplies Company's products. The individual orders which the company received from wholesalers ranged from $50 to $100; total annual purchases ranged from $200 to $3,000 per firm, with an average of $600.

The Rickel Shoe Supplies Company maintained sales branches in 10 of the leading shoe manufacturing centers of the United States. In charge of each branch was a manager who was subject to the control of the sales manager at the central office. A stock of findings and tools sufficient for from one to three months was warehoused at each branch. A perpetual inventory of the stock on hand at each branch was kept. The quantities to be kept in stock at each branch were determined by the central office on advice from the branch manager. Each branch billed all orders which it filled and sent duplicates of the bills to the central office, which made practically all collections. Control over extension of credit also was centralized, but branch managers were allowed to use their own discretion in emergencies.

Twenty-five branch salesmen called upon shoe manufacturers in their respective territories. Another group of six specialty salesmen from the central office called upon the large shoe manufacturers throughout the country in order to assist in building up sales in backward territories and to deal with special sales problems. Five salesmen called upon findings wholesalers. Those salesmen traveled from three of the branches and had wider territories than did the salesmen who sold to shoe manufacturers. The company had sold to findings wholesalers only since 1910. Competition for their business was severe, and in 1922 the company had not yet obtained national distribution through wholesalers. Sales to manufacturers of shoe machinery were made by any of the salesmen who were conveniently located and experienced in making that type of sale. All the salesmen received salaries without commissions. The company emphasized service, and its salesmen were well received by customers. The company advertised in trade journals read by shoe manufacturers and findings wholesalers. The advertisements featured the company's name and directed attention to groups of related products rather than to individual items.

The Rickel Shoe Supplies Company kept no record of its selling expenses by lines of products. It doubled the manufacturing cost of an item to arrive at the selling price, and found that a satisfactory profit usually was obtained by this method if the manufacturing cost had been properly controlled. The company established a unit price for each product. The main units used were, single item, half dozen or dozen, gross, thousand, and pound. The unit selected was determined by convenience of measure, buying habits of customers, and convenience in packaging.

Until 1921 the company had sold its products to all customers at a flat price per unit without regard to the number of units purchased. In order to continue to obtain orders from large manufacturers, however, the company had found that concessions in price were necessary and had given lower prices to about 20 shoe manufacturers who purchased in large quantities. For example, the company sold a tool for which the customary unit price was $1 at a unit price of 95 cents to favored customers purchasing in lots of 100 or more. The company allowed its salesmen no discretion in altering prices to meet competition. Prices

were announced in circulars and catalogs distributed to customers and were subject to change without notice; the prices were changed on an average of once a month. The terms of payment were 2% cash discount for payment by the fifteenth of the month following the month of shipment, and net thereafter. Sales were made f.o.b. mill or f.o.b. branch warehouse. As far as possible, all reasonably large orders were shipped directly from the factory in order that branch stocks might be kept at a minimum. In order to be able to plan production accurately, the company encouraged large purchasers to place their orders in advance. It made deliveries on those orders at fortnightly intervals, billing the customers at the prices in effect when the shipments were made. Ninety days in advance was the maximum period allowed for future orders.

By 1922 the number of favored customers for whom exceptions to the flat price quotations were made had increased, and the sales manager concluded that the flat price structure no longer met the requirements of the company's customers. The flat prices had been established on a basis of purchases of an average customer during periods of normal business. Consequently, in 1922, the company experienced a disadvantage in competing for large orders, and prices were too low to allow the company a fair gross margin on the orders that were smaller than the average. The sales manager wanted a flexible yet simple price plan which would satisfy the requirements of every class of customer and enable the company to meet competition. He believed it essential that standardized policies be enforced in order to minimize operating expenses.

There was no standardized price policy among the manufacturers of shoe supplies. Several competitors of the Rickel Shoe Supplies Company did not have a one-price policy, but bargained for business and accepted whatever prices were necessary in order to obtain orders. Findings wholesalers also sold at varying prices; for example, edgecutters which the company sold to wholesalers at 50 cents each were resold at prices as varied as 60 and 75 cents.

The Rickel Shoe Supplies Company had kept no statistics to show the relative frequency of orders of different sizes. Exact data were not available on the packing, billing, or bookkeeping

expenses for the various sizes of orders, but the company always had considered estimates of such expenses in setting prices. If prices were to be graduated according to the sizes of orders, it would be necessary for the prices to be fixed by executives who were experienced in the sales activities of the company and who knew the prices which the company could obtain in competition with other manufacturers. Despite the lack of exact figures on the cost of handling orders of various sizes, it was evident that if the company could induce customers to place larger orders by offering graduated prices, it could plan its production schedule to correspond more advantageously to shipments.

The company considered two general price plans. One of these plans provided for the establishment of list prices from which discounts would be granted, the size of a discount granted a customer depending upon the class in which that customer belonged. The other plan provided that all customers should pay the same price for equivalent quantities. The company rejected the first plan on the grounds that the wholesalers could not be classified satisfactorily; their heterogeneous character and the wide fluctuations in the sizes of their purchases would cause continual shifts in standing. The executives believed that a price plan was needed which automatically allowed for changes in prices in accordance with changes in buying practices of customers.

The Rickel Shoe Supplies Company decided to base its prices to customers upon the sizes of their individual orders. To facilitate computations, the price structure was based upon multiples of 10. Men experienced in pricing chose a sales unit for each product. Their choice was based upon the common measure used for the product, the sizes of packages necessary to meet the demands of customers, the satisfactoriness with which the unit could be placed upon the multiple of 10 basis, and competitive conditions. After the unit for a product was chosen, the cost of manufacturing that unit was doubled to give the unit selling price. The unit selling price then was multiplied by 10 to give the price per dozen units. The price for a gross of units was 10 times that for a dozen units, and for a great gross of units 10 times the price of a gross. For example, the half-pound was chosen as the sales unit for nails. Nails of a size which cost 10 cents per half-pound to manufacture were sold for 20 cents per half-pound, $2 for 6

pounds, \$20 for 72 pounds, and \$200 for 864 pounds. Whether the measure were number, gallons, or pounds, the prices for the various quantities always were set on a basis of 1, 12, or 144 units. In order to give more flexibility to the price structure, the price per unit, per dozen, and per gross, called the direct shipment prices, were the only prices published. When the plan was decided upon, it was recognized that during the period when the plan was being introduced it might be necessary to depart from the prices per great gross. Exceptions to the general policy, however, were expected to be only temporary. The salesmen and branch managers were not to be allowed discretion in varying prices on large orders. The new price plan was intended to enable the company to quote prices on which it could compete for orders from all classes of customers.

During its experience with the new price structure from 1922 to 1924 the company encountered some difficulties, but was satisfied with the results which it attributed to the new policy. In a few instances the company's prices had been out of line with the customary trade prices. In such cases the company arbitrarily had modified its prices to bring them in line with the customary prices. The smaller shoe manufacturers had not objected to paying higher prices than were paid by the larger purchasers. Numerous instances like the following had occurred. Edgecutters, which prior to the change in price policy had been sold to the wholesalers for 50 cents each and resold by them for from 60 to 75 cents, were placed upon the \$5 per dozen or \$50 per gross basis, with the result that wholesalers obtained their normal margin of profit. Prior to adopting the new plan, the company had had severe competition on one of its tools, which had sold at \$35 per hundred, and its sales of that article had decreased. On the new basis the company sold tools of that type for 50 cents each, \$5 per dozen, or \$50 per gross. Within 90 days after the change the sales of that item had increased to the former volume.

The new price plan assisted in the standardization of packages. For instance, one item previously had been packed by the dozen and had been sold in various odd quantities up to two dozens. The sales unit chosen under the new plan was the half dozen, and that unit was made the standard package at an additional cost of 2 cents per dozen. After the change most customers

purchased the item in standard packages. The savings in handling costs resulting from reduction in sales of broken packages more than offset the extra packing costs. The new plan allowed the company to stabilize prices; the number of monthly price changes was reduced one-half.

The company had difficulty, however, in deciding upon satisfactory units in all instances, mainly because of the impossibility of ascertaining the quantities which customers would be most likely to order. On some items the prices set were not low enough to allow the company to obtain orders. When such an item came to the attention of the sales manager, he figured the manufacturing cost per gross of the item. To this he added about 15%, which approximated selling costs, and then set the selling price per gross at a point where competition could be met if costs permitted. The prices per dozen and per unit then were corrected accordingly. It was the company's experience that most of the difficulties were developmental and eventually disappeared.

Commentary: The quantity discounts which were granted under the price plan adopted by this company amounted on dozen lots to 16⅔% of the selling price computed at the rate for unit purchases, on gross lots to 30½%, and on great gross lots to 42 1/10%. Inasmuch as the wholesalers' average cost of doing business was estimated to be between 20% and 25% of net sales, a wholesaler who purchased in lots of one gross or more and resold at prices based on the manufacturer's unit prices received a discount sufficient to cover his operating expenses and yield a net profit on the materials. When a wholesaler purchased in great gross lots he had a liberal margin on which to operate. Shoe manufacturers, whose purchases constituted 80% of the sales of the company, were offered substantial inducements, under this discount plan, to buy liberally from the Rickel Shoe Supplies Company. Those manufacturers who were able to purchase in great gross lots received fully as low prices as they could have hoped for under the practice of preferential treatment which previously was in effect. The company's one-price plan, frankly stated, and open to all customers on the specified terms, was far more meritorious than the practice of covertly granting preferential treatment to favored customers.

The company's margin above manufacturing cost under the price plan adopted amounted to 50% of the selling price on unit sales, 40% on sales in dozen lots, 28% on sales in gross lots, and 13.6% on sales

in great gross lots. Savings in manufacturing expense as well as in shipping and billing expense resulted from large orders as against small orders. Whether those savings were commensurate with the reductions in the margin cannot be judged without evidence which the company had not compiled. It does not seem probable, however, that on every item the expenses were so much lower on great gross lots, for example, as to warrant a reduction of the company's margin to 13.6%. The rate at which expenses were reduced as the size of orders increased, furthermore, hardly could have been constant for all items. For example, one would not expect ordinarily that as great gain would result from an increase in the size of an order for a standard product, such as nails, from a dozen packages to a great gross as would result from a similar increase in the size of an order for some tool. On a staple product for which the company already had a large volume of output, the reductions in unit costs which would result from an increase in volume were likely to be small. On another product, such as a tool sold infrequently and in small lots, an order for one great gross might readily permit a large reduction of the unit costs by yielding opportunities for more economical use of the manufacturing facilities.

The company's price plan could be easily understood and easily operated. Yet it was not the result of a comprehensive detailed analysis of the costs and other factors which ultimately govern the success of a quantity discount plan. The very simplicity of the plan was likely to occasion more and more exceptions to bring the quantity discounts into conformity with trade practice and to prevent losses on items on which the uniform scale of discounts yielded margins which were unprofitably narrow.

Despite the fact that the plan was likely to be subjected to material modifications, however, it was clearly superior to a varying price policy. It also was distinctly preferable to the scheme of classifying customers by volume of purchases, with a separate rate of discount for each class. Such a classification scheme usually degenerates into varying price practice, with irregular, preferential treatment to customers who are persistent bargainers. That danger was avoided under the company's plan.

April, 1926 M. T. C.

Norval Company[1]

WHOLESALER—CANNED FRUIT

PRICING—*Mark-downs in Anticipation of Market Decline.* Convinced that a general reduction in the price of pineapple was imminent, the company decreased the selling price of the three months' supply of canned pineapple which was on hand and encouraged retailers to emphasize that item. The company disposed of its supply in less than five days.

(1925)

The Norval Company purchased 1,500 cases of pineapple in the latter part of September, 1924. Early in April, 1925, after it had sold 1,050 cases of this merchandise, the company learned that the general level of prices for the new crop was likely to be much lower than the current prices. It seemed, therefore, that a prompt reduction in the company's price for pineapple might be advisable.

The Norval Company had annual sales of about $2,250,000, an annual stock-turn of about 8 times, and an average net profit of about 3% after deduction of interest on owned capital. Salesmen called upon all the customers, most of whom were located within a radius of 25 miles, about once a week. The company had four private brands, under which it made from 40% to 50% of its sales. It always endeavored to obtain high-quality merchandise for sale under the private brands. The company purchased futures in canned goods and also sold futures to its customers.

The company did not departmentize its merchandise, purchase, or inventory accounts, and made no attempt to allocate expenses to departments. It kept a stock record, by items, of the physical inventory of merchandise at the end of each week and of quantities of merchandise ordered. The latter notation was made for each item at the nearest inventory date. The company kept no purchase record cards. On its various lines the company knew the average mark-ups; on canned goods the average gross margin was about 15% of net sales.

When the company succeeded in obtaining merchandise at

[1] Fictitious name.

unusually low prices, it customarily placed on such merchandise only the average mark-up for the line and, consequently, sold the specific lot at less than the general market price. An example of the company's practice of seeking a rapid rate of stock-turn rather than a high percentage of gross margin was as follows. In March, 1925, the company was approached by a packer who had in stock 2,000 cases of a canned commodity of which he was anxious to dispose, as the stock represented merchandise left over from his canning season. He offered to sell the merchandise to the company at $1.20 per case, provided the company purchased the entire lot. In the fall of 1924, the company had purchased 1,500 cases of the same product to be sold under the packer's brand. The company had paid $1.20 a case for the product and had offered it for sale at prices ranging from $1.40 to $1.45 a case. The company still had 900 cases of this article in stock. The merchandise offered by the packer in March, 1925, was superior in quality to the 900 cases of the same product which the company had in stock. Because of this superiority in quality, there normally would be a differential of 15 cents a case between the two grades. If that differential were to be maintained and prices on the stock previously purchased were not to be reduced, the lot offered in March, 1925, would have been sold by the wholesaler at prices ranging from $1.55 to $1.60 a case. These selling prices would have allowed the company a gross margin of about 25% of sales. The company also had the same product, of a quality slightly higher than that of the 2,000 cases, for sale under its private brand. The company was selling this private-brand merchandise at $1.65 a case.

The company decided to purchase the 2,000 cases under the manufacturer's brand, and immediately sold 900 cases to a chain store company at $1.35 a case; the merchandise was shipped directly from the packer to the warehouse of the retail company. The company placed a price of $1.45 on the remaining 1,100 cases and sold them in 6 days, obtaining, therefore, an average gross margin on the 2,000 cases of less than 15% of sales.

Some of the executives of the company had questioned the advisability of selling the merchandise at $1.45 a case, which meant a retail price of 15 cents a can, in view of the fact that the company was selling the same product of slightly higher qual-

ity under its private brand at $1.65 a case, which resulted in a retail price of 18 cents a can. These executives had thought that some housewives might decide that the difference in quality of the private brand did not justify its price. However, in the 6 weeks following the sale of the 2,000 cases there had been no evidence that the company's action had injured sales under its private brand. The president of the company believed that a housewife who had found the merchandise satisfactory at a price of 18 cents a can would hesitate to try a 15-cent grade.

When retailers who had purchased merchandise from the company at less than the market price requested more of that merchandise, the company explained that its offer had been a special one and that consequently no more of the article was in stock. The president found that this practice, instead of causing ill will on the part of the retailers, impressed them with the value of the special offers made by the company.

Early in April, 1925, the president of the Norval Company learned that there was a possibility that the price of canned pineapple would be reduced sharply with the opening of the new season in the early fall. Current rumors to that effect and the opinion of brokers whom he consulted convinced the president that a reduction was almost certain to take place.

At the beginning of the 1924-1925 season, the company had purchased 1,500 cases of pineapple for its private brand at $2.50 a case of 12 cans. The company had sold 1,050 cases in the 6 months preceding April 1, 1925, at $3.15 a case. Retailers were selling this pineapple at 35 cents a can.

Although no competitor had reduced prices on pineapple and the company did not know what new pineapple would cost, the company reduced the price of its pineapple to $2.85 a case, urging the salesmen to place special emphasis upon the item and instructing them to sell not more than two or three cases to each retailer. It was the company's policy to prevent overbuying by retailers. The company believed that few, if any, of its customers would be overstocked with pineapple. The salesmen instructed the grocers not to purchase the item unless they intended to reduce the price and to sell quickly the amount purchased. The company advised retailers to display the merchandise prominently and to sell it at a price of 29 cents or 30 cents a can. The

company sold the 450 cases of pineapple which it had in stock in less than 5 days.

The salesmen found only one retailer who had a comparatively large quantity of the Norval Company's pineapple in stock. That retailer had purchased five cases of pineapple from the company shortly before the price reduction and still had four cases. The company told him that if he would purchase five cases more and offer the entire quantity to his customers at a special price of 29 cents a can he could have the pineapple at a price of $1.75 a case.

Within less than 2 weeks after it made the price reduction, the company was offered by a competing wholesaler 200 cases of pineapple at a price of $2.10 a case. This pineapple was of exactly the same quality as that sold by the Norval Company, the two wholesalers having purchased from the same canner and at the same price. The competitor had kept the pineapple in stock for about six months. Since the competitor had not placed a private brand on the cans, the Norval Company accepted the offer.

The president of the Norval Company enumerated as follows some of the advantages which had resulted from the company's action in anticipation of a general price reduction. The company had sold 450 cases of the pineapple to retailers. When competitors reduced their prices the following week, they found that retailers had sufficient supplies. The sale of the 450 cases in 5 days had released capital which otherwise would not have been free for some time, and the reduction of inventory in the one line improved the stock-turn of the company as a whole. The company, moreover, by disposing of its stock of pineapple had placed itself in a position to accept any exceptionally good offer that was made. Retailers in actively soliciting orders for the item at the reduced price had advertised the company's private brand; for one week the company's brand had been pushed by retail grocers. The president was convinced that this had created a favorable impression in the minds of the customers which would be reflected in increased sales of other lines.

Commentary: The company succeeded in selling several special lots of canned fruits by cutting its prices below the general market prices. Inasmuch as those ventures were successful, it is unnecessary to dis-

cuss the merits of the individual transactions. This case, however, opens up a highly interesting and significant question. That question is whether the demand for such merchandise as canned pineapple is so elastic that a relatively small reduction in price will rapidly stimulate sales.[2]

The success of the wholesale grocery firm in effecting the rapid sale of pineapple and other canned goods by reducing prices may have been caused by the elasticity of the demand for such merchandise or it may have been the result of the failure of the retailers to foresee the market decline. If the retailers to whom the merchandise was offered expected the market price to remain stable, they naturally would grasp the opportunity to purchase merchandise at bargain prices. Another possible explanation is that the company took the initiative in a highly competitive field and thereby disposed of its merchandise expeditiously, while if other wholesalers had reduced prices simultaneously, other results might have been experienced by the Norval Company.

No final conclusion regarding the policy of price reduction can be drawn from this case. When numerous other cases are available to furnish evidence on the same point, this record of experience will prove valuable. A broad compilation of such experiences would reduce the amount of guesswork now resorted to in pricing merchandise of varying seasonal supply and would indicate how far success of such a policy as that followed by the Norval Company is the result of underlying economic factors and how far it reflects general ignorance of customers and competitors or their lack of judgment in foreseeing changes in market prices.[3]

November, 1925 M. T. C.

[2] For a discussion of elasticity of demand in another industry, see commentary on the case of the California Fruit Growers' Exchange, page 132.

[3] Some additional information as to the practice of wholesale grocery companies in reducing prices to stimulate sales or move inactive stocks is contained in the case of the Covelle Company, page 229. See also the cases of the Pillimer Company, and the Harcourt Company, Bureau of Business Research, Harvard University, Bulletin No. 55, *Cases on Merchandise Control in the Wholesale Grocery Business,* pp. 31 and 151.

Tulsa Cotton Manufacturing Company[1]

MANUFACTURER—COTTON GREY GOODS

Pricing—*Determination of Prices on Basis of Estimated Future Costs.* In April, 1924, current market prices for cotton grey goods such as the company manufactured were too low to meet the company's cost of production at the prices that it had paid for the raw cotton which it had on hand. The company's cost of production on the basis of October cotton futures was above the current market prices, although below the actual cost. The company decided to hold the output of its mill for prices based on the future cost of cotton as indicated by October futures quotations.

Output Control—*Continuance of Production in Anticipation of an Increase in Price.* The current market prices for cotton grey goods such as the company manufactured were less than the company's cost of production. Since cotton futures and other indications led it to anticipate increases in the prices of cotton cloth, the company decided to continue to manufacture and to hold the stocks of finished goods for higher prices.

(1924)

In April, 1924, the mill of the Tulsa Cotton Manufacturing Company was operating on a day and night shift and was employing approximately 850 workmen. The company had no stocks of cloth on hand and had practically no unfilled orders. It did have on hand, however, sufficient raw cotton to meet manufacturing requirements through the second week of July, 1924, at the current rate of production. The company had purchased the cotton during the autumn of 1923 and the winter of 1923 and 1924 at an average price, the treasurer estimated, of 31½ cents a pound. The current market prices for staple grey goods such as the company manufactured were insufficient to cover the company's costs of production, with raw cotton costing 31½ cents a pound. If the company sold its output of staple grey sheeting currently, for example, it could obtain a price of 13¾ cents a yard, while the actual cost of production was 16⅛ cents a yard. On the basis of October cotton futures quotations, the cost of the sheeting would be 14⅜ cents a yard. The executives of the company thought that it might be advisable to hold the mill's

[1] Fictitious name.

output of sheeting for that price or for a higher price, rather than to undertake to sell as much as possible at the current price. Whatever policy the company followed for this sheeting, it also would follow for the other cloth which it manufactured.

The Tulsa Cotton Manufacturing Company was located in Alabama and in 1923 produced approximately 8,300,000 yards of grey cloth. Twenty-eight per cent of this output was of staple grey sheeting 36-inch, 48 by 48, 3.00; this sheeting was 36 inches wide and 3 yards of it weighed 1 pound. Raw cotton constituted more than two-thirds of the total cost of this cloth. The net waste of raw cotton in the production of the sheeting amounted to 12% of the cost of the cotton content. Total costs for labor, overhead, interest, and depreciation averaged 11 cents a pound of cloth. The executives were of the opinion that the manufacturing costs of the company's mill probably were less for this cloth than were those of any competing mill. The company sold through a selling agent, and that agent's commission was 4% of selling price.

Grey sheeting was a staple product in the cotton industry and was manufactured by many American cotton mills. The Tulsa Cotton Manufacturing Company sold approximately 50% of its output of grey sheeting for export to the Orient, where the sheeting was used for making tunics and robes. The company's domestic sales of the cloth were made chiefly to manufacturers of bags for flour and wheat. The looms used for the sheeting also could be used for the manufacture of automobile cloth.

Ordinarily, mills producing cotton cloth did not regulate their purchases of raw cotton by known manufacturing requirements. Instead, they purchased at irregular intervals, in an attempt to secure supplies of raw cotton when prices were especially advantageous. It often was necessary, however, for the mills to purchase in the early autumn when the new crop came on the market, in order to insure a supply of raw cotton of the grade and quality needed. Furthermore, the mills attempted either to hold their product or to sell it for future delivery, according to the expected trends of prices for cloth.

Exhibit 4 shows the relation of sheeting prices and costs from November, 1920, to March, 1924. The broken line shows the price per pound on Monday of each week during that period for

EXHIBIT 1

COTTON PURCHASES OF TULSA COTTON MANUFACTURING COMPANY AND AVERAGE PRICES BY WEEKS, JANUARY 1, 1923, TO MARCH 31, 1924

1923 Week of	Pounds Purchased	Average Price per Pound for the Week
January 1	50,000	26.42 cents
January 8	100,000	27.10
January 15	370,000	28.3689
January 22	200,000	28.25
February 26	1,350,000	30.6972
March 5	100,000	31.17
May 7	200,000	25.045
May 14	50,000	25.57
July 23	150,000	21.875
July 30	200,000	21.47
September 10	550,000	26.8464
September 17	250,000	28.85
September 24	850,000	28.30
October 1	262,500	27.7095
October 22	400,000	30.3625
October 29	875,000	30.5221
November 5	875,500	32.5477
November 12	435,000	33.1865
November 19	500,000	33.10
November 26	420,000	34.2845
December 3	200,000	34.44
December 10	12,500	33.20
December 17	10,500	34.00
1924		
January 24	62,500	32.75
February 15	260,000	30.887
February 27	250,000	29.43
March 1	152,000	28.27
March 15	2,000	31.00
March 31	1,500	26.125

spot cotton, according to the New York market quotation, after allowance for net waste in manufacture. The dotted line represents the cost at the mill of 36-inch, 48 by 48, 3.00 sheetings. That line was constructed by the addition of the manufacturing cost per yard to the raw cotton cost per yard as shown in the

Exhibit 2

Orders Taken by Tulsa Cotton Manufacturing Company for 36-Inch Staple Grey Sheeting, in Pounds of Raw Cotton Equivalent, Totaled by Months, November, 1920, to April, 1924

Month	Orders Taken for Cloth Expressed in Pounds of Raw Cotton Equivalent*
1920	
November	20,784
December	65,488
1921	
January	38,039
February	85,884
March	8,626
April	277,649
May	133,725
June	116,865
July	84,708
August	543,528
September	19,218
October	113,725
November	8,282
December	20,786
1922	
January	9,805
February	227,449
March	119,607
April	20,001
May	145,098
June	77,257
July	3,530
August	169,411
September	16,103
October	838,431
November	141,962
December	231,828
1923	
January	181,961
February	46,009
March	271,373
April	55,196
May	36,078
June	88,234
July	78,822
August	312,553
September	748,238
October	39,607
November	214,508
December	6,078
1924	
February	117,000
April	155,510

*Allowance was made for waste of raw cotton in manufacturing, amounting to 12% of the cost of the cotton entering into the cloth, or to 15% of the weight of the cloth.

Exhibit 3

Raw Cotton Imports, Exports, Mill and Warehouse Stocks, and World Visible Supply, September, 1921, to April, 1924*

Month	Imports (Bales)‡	Exports (Bales)‡	Stocks End of Month: Mills (Bales)‡	Stocks End of Month: Warehouses (Bales)‡	World Visible Supply† (Bales)‡
1921					
September	6,362	532,839	1,118,045	4,312,135	3,944,690
October	31,269	874,510	1,398,138	4,984,831	4,519,489
November	51,440	648,695	1,655,359	5,292,941	4,622,596
December	61,006	639,825	1,738,138	5,206,663	4,617,751
1922					
January	42,093	475,910	1,668,668	4,621,708	4,322,285
February	54,761	338,440	1,595,242	4,214,862	3,890,580
March	59,957	461,484	1,557,023	3,752,258	3,592,532
April	15,115	598,209	1,461,340	3,213,483	3,398,909
May	14,320	469,397	1,420,428	2,559,451	3,000,680
June	12,662	491,079	1,330,903	1,953,478	2,567,689
July	8,587	373,242	1,218,388	1,488,165	2,839,888
August	14,678	273,308	1,024,874	1,530,141	1,597,056
September	5,012§	368,390	1,065,816	3,217,939	2,228,591
October	26,816	798,664	1,381,945	4,287,119	3,637,150
November	49,551	858,337	1,724,488	4,197,955	3,876,414
December	68,547	607,853	1,917,231	4,069,470	3,811,650
1923					
January	105,215	473,436	1,988,115	3,485,952	3,359,121
February	66,329	359,657	2,020,900	2,803,306	2,733,781
March	53,219	318,210	2,033,837	2,379,697	2,335,063
April	37,271	262,753	1,878,198	1,965,714	1,812,705
May	23,593	160,368	1,634,167	1,580,219	1,432,114
June	13,367	214,851	1,347,468	1,227,184	1,108,674
July	6,356	171,469	1,093,618	938,903	865,392
August	3,420	244,415	806,671	1,179,204	913,949
September	6,608	689,435	773,173	2,147,830	1,597,605
October	7,615	781,722	1,102,583	3,485,839	2,784,991
November	16,564	770,002	1,438,813	3,770,542	3,226,125
December	35,601	845,581	1,623,453	3,526,164	3,404,786
1924					
January	47,693	546,853	1,637,824	2,963,983	4,477,084
February	48,602	482,146	1,583,439	2,497,075	4,584,208
March	49,833	332,168	1,503,852	2,000,552	4,127,222
April	40,435	320,774	1,329,901	1,510,619	3,520,382

*Information taken from *Survey of Current Business*, United States Department of Commerce, Washington, No. 30, February, 1924, p. 61, and No. 48, August, 1925, p. 36.

†These figures represent world visible supply of American cotton.

‡All bales are running bales counting round as half-bales, except for imports, which are given in equivalent 500-pound bales.

§Covers first 21 days only, during which period the old tariff law was in effect; remaining 9 days included with October.

broken line. The solid line indicates the selling prices of this sheeting at the mill on the same dates, after deduction of the selling agent's commission of 4%. These curves illustrate what would have been the relation between the costs and selling prices of the sheeting if the prices of the cotton used in the manufacture of the sheeting had been the same as the prices prevailing at the time the sales were made.

The monthly production of the Tulsa Cotton Manufacturing Company had been nearly constant from 1921 to 1924. Exhibit 1 shows the company's purchases of raw cotton in pounds, totaled weekly, from January, 1923, to March, 1924, and the price per pound, averaged for each week during that time. With 1914 prices as 100, prices of raw cotton in the autumn of 1923 and the winter of 1923 and 1924, ranged from 224 in September, 1923, to 278 in January, 1924, while on the same basis prices of grey goods in those months were 207 and 228 respectively. From January, 1920, until January, 1923, prices of grey goods had advanced more rapidly than had prices of raw cotton. After that time, however, prices of cotton were relatively lower than prices of grey goods.[2] Exhibit 2 shows the orders which the Tulsa Cotton Manufacturing Company took for the 36-inch staple grey sheeting, totaled by months and expressed in terms of the raw cotton equivalent, during the period from November, 1920, to April, 1924.

Exhibit 3 shows raw cotton imports, exports, mill and warehouse stocks, and world visible supply, by months from September, 1921, to April, 1924.

One suggestion made in April, 1924, was that the Tulsa Cotton Manufacturing Company should operate only part time until prices of grey goods had increased. The executives estimated that as long as the mill was operated at least four days a week the working force could be held together. The company was financially able to carry stocks of cloth. The executives were convinced that raw cotton prices were not likely to fall below the October futures quotation, which was 24 cents a pound. They believed, furthermore, that prices of grey goods had anticipated the decrease which would occur in the price of raw cotton after

---

[2] See *Textile World,* April 11, 1925, for index numbers of raw cotton, cotton yarns, and cotton grey goods, January, 1920, to October, 1924.

the new crop was placed on the market. The executives decided, therefore, to manufacture for stock and to hold the goods until they could be sold approximately at cost computed on the basis of October cotton futures. For the staple grey sheeting this would mean a price of 14⅜ cents a yard.

COMMENTARY: The question raised in this case is typical of those which continually confront companies manufacturing staple cotton fabrics, as well as manufacturers in numerous other industries: shall we accept orders at current prices, or shall we manufacture goods for stock and hold them for higher prices?

In this particular instance loss was inevitable. The raw cotton on hand had been bought at prices substantially above the spot prices in April, 1924, and also above the prices for October futures at that date. The company had misjudged the market earlier in the crop year. In April, 1924, there was no reason for believing that sheeting prices would rise in the near future to 16⅛ cents a yard, the price that it would have been necessary for the company to obtain if it were to avoid loss on the stock of raw cotton on hand. This conclusion restricted the question to a choice between accepting orders for immediate delivery at 13¾ cents a yard, the current market price, and delaying acceptance of orders until sheeting prices reached 14⅜ cents a yard, the cost on the basis of October futures, or until some event occurred which showed clearly what prices were to be obtainable during the next three months.

From the production standpoint the task was to plan operations on a schedule which would enable the company to retain its employees. This could be done by running the mill part time. Whether the company manufactured for stock or for immediate delivery, its costs would be about the same. The raw material already was on hand, and the carrying charges to be borne would not be greatly higher for cotton manufactured into cloth than for cotton in bales. No changes in manufacturing costs were anticipated. Hence it was advisable to operate the mill on a schedule of four days a week.

At the time when this question arose, the cloth market was weak and the general business outlook spotty. Nevertheless, there were no large stocks of cloth held by this mill or by other mills making similar goods, and the prices of cloth were below the future market price indicated by October futures for raw cotton. This fact suggested a tendency for prices to strengthen rather than to weaken. The data given in the accompanying tables and chart show that sheeting prices had been below the cost of production for almost a year. That circumstance did not encourage hopes of obtaining normal profits in the near future. It was not a reason, however, for selling at the current prices. Inas-

much as sheeting prices seemed unlikely to go to a lower point within a few months, as far as could be judged from the information at hand, the company properly decided to manufacture for stock with the intention of accepting orders at a price governed by the anticipated future price of raw cotton, or at least at a price higher than the market price in April, 1924. The chief risk which the company incurred was the possible loss of carrying charges, and the possibilities of an improvement in the cloth market were great enough to warrant running that risk.

This case affords another illustration of the uncertainty which attends the quoting of prices in many industries.

May, 1926 M. T. C.

Gerard Ginger Ale Company[1]

MANUFACTURER—GINGER ALE

Pricing—*Determination of Price for New Product.* The company, which undertook to sell a full line of ginger ales and other soft drinks, manufacturing some and acting as manufacturers' exclusive agent for others, decided to manufacture and market a new ginger ale. The company decided that the new product should be sold at retail at a price sufficient to yield a satisfactory net profit, but less than the prices of competing products of corresponding quality.

(1925-1926)

The Gerard Ginger Ale Company endeavored to sell a wide enough variety of ginger ales and other soft drinks to meet whatever demands might be made upon it, both as to type of product and as to price. Because of an apparently growing popularity of pale dry ginger ale, the company in the spring of 1925 planned to manufacture and market in New England a pale dry ginger ale to be known as Gerard Pale Dry. This product was expected to be equal in quality to the leading brands of dry ginger ale on the market and was to be attractively put up in green bottles with gold-colored foil around their tops. The executives of the company wished to set the price of the new ginger ale at a level that would mark it as a product of high quality and that at the same time would stimulate sales.

The plant of the Gerard Ginger Ale Company, located in Worcester, Massachusetts, had a maximum daily capacity of 675 cases of 24 16-ounce bottles each. The average output was 600 cases per day. The company's manufacturing peak came in the summer months, although the executives discerned a growing tendency toward a uniform demand throughout the year. The executives estimated that 40% of the company's sales were made in Worcester and that 60% were made in other parts of New England. The company sold to wholesalers, retailers, and in some instances directly to consumers. Its products were on sale at grocery stores, restaurants, hotels, country clubs, drug stores, and confectionery stores.

In 1925 the company was manufacturing three brands of

[1] Fictitious name.

ginger ale and a group of other soft drinks, in a variety of flavors, known as First-class Beverages. In addition to the items which it manufactured, the company sold, as manufacturer's exclusive agent for a section of the state, Everst ginger ale, a well-known brand, and several other widely advertised soft drinks. Sales of these manufacturers' brands constituted a substantial portion of the company's total sales. None of the ginger ales which the company sold was pale. One, manufactured by the company and known as Gerard Super Dry, was stated to be equal in quality to the best ginger ales on the market. The other ginger ales which the company manufactured, Elite and Green Mountain, were of average quality. The new ginger ale would be of the same quality as Gerard Super Dry but would be pale instead of dark, and the bottles would be more attractive in appearance, since the bottles used for Gerard Super Dry were uncolored and were not decorated with foil.

Exhibit 1 shows the selling prices for Elite ginger ale, Gerard Super Dry ginger ale, and Everst ginger ale. The retail selling prices given in the table were those suggested by the company and were the lowest prices at which the items ordinarily were sold. The prices charged for ginger ale by various types of retailers were not uniform. Grocery stores generally sold at the prices suggested by the company. Soda fountains and confec-

EXHIBIT 1

PRICES TO WHOLESALERS, RETAILERS, AND CONSUMERS, FOR ELITE GINGER ALE, GERARD SUPER DRY GINGER ALE, AND EVERST GINGER ALE

Brand	Size of Bottle (Ounces)	Number of Bottles per case	Price to Wholesaler per case*	Price to Retailer per case*	Retail Selling Price per bottle†
Elite	8	24	$1.05	$1.25	$.05
	16	24	1.50	1.90	.10
	28	12	1.75	2.10	.15
Gerard Super Dry	8	48	3.40	4.00	.10
	16	24	2.25	2.75	.15
Everst‡	16	50	6.55	7.75	.20

*Inclusive of rebates for bottles and case.
†Exclusive of rebates for bottles.
‡The Gerard Ginger Ale Company acted as manufacturer's agent for Everst ginger ale.

tionery stores sometimes charged an advance of 5 cents a bottle, while clubs, hotels, and restaurants frequently charged an advance of 10 cents or more a bottle.

The company allowed wholesalers a rebate of 50 cents per case for the return of bottles and cases, except for a case of Gerard Super Dry 8-ounce bottles, a case of Elite 28-ounce bottles, or a case of Everst 16-ounce bottles, for which the rebate was $1. The wholesalers allowed similar rebates to their customers. The wholesale cost and selling prices given in Exhibit 1 included the charges for bottles, since it was customary to bill the gross amount. The retail selling prices, however, did not include retailers' charges for bottles. There was no uniform policy among retailers regarding the amount of deposit required for a bottle. At soda fountains, for instance, the selling price usually was the net amount, because the bottles seldom were taken from the stores. Many retailers made extra charges of 2 cents a bottle for the 16-ounce Elite brand, 5 cents for the 28-ounce Elite brand, and 2 cents for the 16-ounce Gerard Super Dry brand. Those extra charges were rebated when bottles were returned. The company estimated that on about 75% of its sales the bottles and cases were returned for rebates.

Gerard Pale Dry ginger ale was to be sold in 12-ounce bottles in cases of 24 bottles each and in cases of 50 bottles each. One of the most widely advertised brands of pale dry ginger ale on the market was sold in 6-ounce bottles, called splits, as well as in 12-ounce bottles. The Gerard Ginger Ale Company contemplated selling Gerard Pale Dry eventually in 8-ounce bottles and also in 28-ounce bottles, but the initial marketing plans were confined to the sale of 12-ounce bottles. The company's estimate of the manufacturing and selling costs of Gerard Pale Dry ginger ale is given in Exhibit 2.

The total manufacturing and selling costs of a case of 24 16-ounce bottles of the company's First-class Beverages exclusive of costs for bottles and case was 62 cents. The selling price to wholesalers exclusive of rebates for bottles and case was 92 cents, thus allowing the company a margin of 30 cents a case, or 33% of net selling price. For a case of 50 16-ounce bottles of Everst ginger ale the company paid the manufacturer $4.89 exclusive of rebates for bottles and cases. The company sold this ginger ale

Exhibit 2

Estimated Manufacturing and Selling Costs of Gerard Pale Dry Ginger Ale

	Cost per Case of 50 12-Ounce Bottles
Contents, including labor, and caps and labels	$1.20
Case	.385*
Bottles	.84*
Bottle wrappers	.17
Paper sheets used in packing	.015
Gold foil	.10
Labor in packing	.10
Advertising and selling	1.19
Total Cost	$4.00

*The costs for bottles and cases were the average costs allowing for reuse of those returned for rebates.

to wholesalers for $5.55 a case exclusive of rebates, thus taking a margin of 66 cents a case, or about 12% of the net selling price.

One of the most widely sold brands of dry ginger ale in the eastern section of the United States ordinarily was priced to consumers at 20 cents per 12-ounce bottle. The cost of that brand to retailers varied because freight was charged from the factory, which was located in New York State. That brand was sold through manufacturer's agents in metropolitan districts, and in Boston the delivered cost to retailers was $8.50 per case of 50 bottles. The brand was advertised widely. The retail price of 20 cents was stated in the advertisements and was not cut by retailers.

The Gerard Ginger Ale Company intended to sell Gerard Pale Dry ginger ale through the same channels that it used for the other products which it sold. The executives were of the opinion that wholesalers should be allowed a gross margin of from 10% to 15% on their selling price and that retailers should be allowed a margin of from 33⅓% to 45% on the selling price. A large margin of profit for retailers could be expected to insure their cooperation in the introduction of the new product.

The company planned to advertise the new ginger ale extensively in New England newspapers. The amount to be spent depended largely upon the gross margin secured. The executives

were informed that a company which produced one of the leading brands of domestic ginger ale spent 10 cents a case per year in national advertising and realized a net profit of about 15 cents a case. The sales volume of that company was believed to be in excess of 2,000,000 cases a year.

The Gerard Ginger Ale Company for several years prior to 1921 had advertised its products intensively in newspapers and by means of billboards. Sales had declined, however, and the company had discontinued its advertising for the most part. Its name appeared in the local advertisements of the manufacturers whose brands it carried and, since all its own products bore its name, those products served to advertise each other.

It was the opinion of the executives that the company could compete successfully with the leading brands of pale dry ginger ale in New England by allowing retailers a larger gross margin than was allowed them on those brands. The retailers' gross margin on one of the foremost brands varied from 15% to 20%, depending upon the distance that the merchandise was shipped, since retailers paid the freight charges. Retailers found it advisable to carry that brand, because of the demand which had been stimulated for it by the manufacturer's advertising.

In 1925 the president of the Gerard Ginger Ale Company believed that Gerard Pale Dry ginger ale could be sold at a retail price of more than 20 cents per bottle. Dry ginger ale was sold to consumers with high purchasing power and, in the president's opinion at that time, price was not a controlling factor in its purchase. A well-established brand of imported dry ginger ale sold at retail for 35 cents per bottle. Although the market for high-priced ginger ale was restricted, the executives believed that the demand for pale dry ginger ale was increasing.

Arrangements were not completed for the manufacture and marketing of Gerard Pale Dry ginger ale until late in the summer of 1925, when the sales peak for soft drinks already was past. The company decided, therefore, to delay the introduction of the new product until the next spring.

Gerard Pale Dry ginger ale was introduced in February, 1926. Two months later the company had sold 350 cases of 50 bottles each and 125 cases of 24 bottles each. About 70% of those sales were made in Worcester. In May, 1926, three of the company's

salesmen were calling upon wholesalers and large retailers in several of the New England states. Those salesmen solicited orders for all the company's products but emphasized particularly Gerard Pale Dry ginger ale. The first Sunday after the product was placed on the market the company inserted a full-page advertisement in the rotogravure section of a local newspaper. Each Sunday thereafter the company inserted a quarter-page advertisement of the new product in that section of the newspaper. The company also advertised in local theater programs. The advertisements stressed the high quality of the product and referred to it as supplementing Gerard Super Dry ginger ale. The advertisements made no reference to price.

The prices which the company finally decided upon for Gerard Pale Dry ginger ale were as follows:

EXHIBIT 3

SELLING PRICES OF GERARD PALE DRY GINGER ALE

	Case of 50 12-Ounce Bottles*	Case of 24 12-Ounce Bottles†
Price to Wholesaler	$5.00	$2.40
Price to Retailer	6.00	2.85
Price to Consumer	8.50	3.25

*A rebate of $1 was allowed for the return of bottles and case.
†A rebate of 36 cents was allowed for the return of bottles and case.

The company's actual costs for Gerard Pale Dry ginger ale were the same as the estimated costs shown in Exhibit 2 except that the cost of bottles was 91 cents instead of 84 cents. The usual net selling price of the beverage to consumers was 15 cents a bottle, although in some instances the price was much higher. The prices decided upon yielded the company a gross margin, computed on a basis of total costs other than those for bottles and cases, of 30.6% of selling price exclusive of charges for bottles and cases. The wholesaler's gross margin, also computed on costs and selling price exclusive of charges for bottles and cases, was 20%. The retailers' gross margin, on the same basis, was 33.3%.

In the six months prior to February, 1926, when the new product was placed on the market, the executives of the company

had come to the conclusion that with increasing competition price was becoming a more important factor in the sale of high-grade ginger ale. They deemed it advisable, therefore, to sell Gerard Pale Dry ginger ale at a price lower than the prices of widely advertised competing brands. They were satisfied with the sales of the first few months and expected later to put the new product up in 6½-ounce bottles as well as in 12-ounce bottles.

Commentary: The determination of the normal retail selling price as the starting point from which to compute wholesalers' and manufacturer's selling prices was the basic problem in this case. At a retail selling price of 15 cents a bottle fair gross margins to retailers and wholesalers and to the company itself could be obtained. At a retail selling price of 20 cents a bottle or at a higher price, more liberal margins could have been allowed to wholesalers and retailers and the company could have secured a greater profit per bottle. The rate of profit per bottle was by no means the only consideration, however, for it was necessary to take into account the probable effects of the different prices on the volume of sales in the immediate future and also over a longer period of time.

A retail price of 20 cents a bottle would have made it practical for the company to allow a wider gross margin to retailers. On the other kinds of ginger ale manufactured by the company the gross margin to retailers ranged from 37½% to 41⅔% of the retail selling prices. On the scale of prices adopted by the company, when the retailers sold Gerard Pale Dry ginger ale at 15 cents a bottle, the retailers' gross margin was 33⅓%. Yet, inasmuch as the company's products already were well known to retailers and pale dry ginger ale was in demand, there was no special risk to the retailers in taking on the new product, nor did the company apparently expect the retailers to put forth special effort to sell the product. By furnishing the retailers with a brand of pale dry ginger ale which could be sold at a price lower than the prices placed on competing brands, the company made it possible for retailers who sold Gerard Pale Dry to enjoy a competitive price advantage. As far as the retailers' gross margin was concerned, therefore, the 15-cent price was practical.

If the normal retail price for Gerard Pale Dry had been placed at 20 cents a bottle, it would have been on a par with the price for one of the successful brands of pale dry ginger ale. The executives of the Gerard Ginger Ale Company apparently were of the opinion that the initial success of other companies in selling pale dry ginger ale at sub-

stantially higher prices than were charged for other kinds of ginger ale had resulted not only from the intrinsic qualities of that beverage but also from its novelty and from the luxury distinction which well-to-do consumers enjoyed in purchasing a high-priced beverage. As the novelty wore off and the beverage became more commonplace, the sale of pale dry ginger ale at a substantial differential above the prices for other beverages would become more and more difficult. This was a particularly strong reason for placing the retail price of Gerard Pale Dry at 15 cents rather than at 20 cents a bottle. The company could gain some strategic advantage by taking the lead in this competition.

In selecting the price for Gerard Pale Dry it also was necessary to give consideration to the relation of that beverage to other beverages manufactured by the company. The new product was added to complete the company's line, not to supplant other beverages. The retail price of 15 cents a bottle was in conformity with the general level of the prices at which the other beverages manufactured by the company were sold. Thus the same merchandising methods could be used for the new product as for the remainder of the line, a highly desirable condition. In so far as the 15-cent price on Gerard Pale Dry helped to render pale dry ginger ale more commonplace, furthermore, it would tend to weaken the competition of other brands of pale dry ginger ale with the Gerard Ginger Ale Company's general line of beverages.

The selection of 15 cents a bottle as the normal retail selling price, therefore, was in accordance with the general merchandising plans of the company.

May, 1926 M. T. C.

Fox Mills[1]

MANUFACTURER—UNDERWEAR

Pricing—*Adjustment of Prices to Variations in Costs.* The company produced numerous styles of underwear in a variety of sizes and finishes. Costs varied between sizes and finishes, but with few exceptions the company placed the same selling price on all sizes and finishes of each style. A proposal was made to adjust prices to conform to differences in costs.

(1922)

In 1922 it was proposed that the Fox Mills, which manufactured underwear, should discontinue using an average figure in pricing various sizes and finishes of each style of underwear and adopt a method whereby each size and finish of a particular style would bear a price proportional to its cost. The company's products were classified into men's, women's, boys', misses', and children's garments; these classes were subdivided into union suits, shirts, and drawers; and a further subdivision was made into 3 heights of neck, 4 lengths of sleeves, and 3 lengths of legs. These types of garments were offered for sale in 55 fabrics, composed of combed or carded yarns, cotton, wool, silk, and mixtures, and knitted in several ways. Each style was manufactured in an assortment of sizes. Children's sizes were 1, 2, 3, 4, 5, and 6; the prices for children's garments varied between sizes. Boys' and misses' sizes were 2, 4, 6, 8, 10, 12, 14, and 16; for these garments no price variations were made on a basis of size. Men's sizes ran on the even numbers from 34 to 50 and were divided into regulars and stouts, which were sold at the same prices. Women's sizes were divided into regulars and extras. The regular sizes, 4, 5, and 6, were sold at one price, and the extra sizes, 7, 8, and 9, were sold at a slightly higher price.

The selling prices varied between fabrics and between the major classes of products, but with the exceptions just stated, no differentiations in price were made between sizes of the same style or for different heights of neck or lengths of sleeves and legs. When the price for a style was to be determined, the sales of that style in dozens were estimated and the total manufactur-

[1] Fictitious name.

ing cost for that quantity was figured. The average gross margin necessary for meeting general management expense, selling expense, and net profit was 27% of net sales. That was equivalent to 37% of cost. The addition of 37% to the estimated cost, therefore, gave the figure for the estimated sales of that style in dollars. Total sales in dollars were divided by the total number of dozens of estimated sales to determine the average selling price per dozen in that group. An example of this method of figuring prices follows:

STYLE NUMBER 673 (LADIES')

Neck	Cost per Dozen	Estimated Sales in Dozens	Total Mill Cost	Selling Price to Retailers per Dozen
High	$6.82	1,000	$ 6,820	$7.80
Dutch	5.83	8,200	47,806	7.80
Band Top	3.04	800	2,432	7.80
		10,000	$57,058	

The mark-up of 37% on the total mill cost amounted to $21,111. The addition of that amount to the total mill cost gave a figure for estimated sales of $78,169. The estimated sales in dozens being 10,000, the selling price was placed at $7.80 a dozen.

The cost per dozen included labor, material, and factory overhead expense. Costs were built up on a pound basis. Most of the operations were paid for on a piece rate system; thus the direct labor cost could be reduced to a definite amount per pound. To this direct labor cost, indirect labor costs were added at a standard rate, and to the entire labor cost the overhead was added, also at a standard rate per pound. The costs attributed to the different sizes and finishes of a particular style varied, consequently, because of differences in the quantities of material required. To determine costs for a particular style and finish, the usual ratio of the sales of each size to the total sales of the group was determined from previous sales records. For example, sales of sizes of one style of garment usually were as follows:

Size of garment	4	5	6	7	8	9
Sales in dozens	1	3	5	4	4	4

By use of this ratio, the average weight per dozen garments sold of that style was determined, and the costs, which were built up on a basis of the weight of the fabric, were computed.

The treasurer of the Fox Mills believed that it was inadvisable for the company to sell any of its products at a loss and, furthermore, that it was only fair that customers should pay in proportion to the cost. Hence, he proposed to base the price of each size and type of garment on its actual cost. The company had taken a step in this direction a few years previously when it had changed its method of pricing children's underwear. Consumers had expressed the opinion that garments for a four-year-old child, for instance, should not bear the same prices as those for a ten-year-old child. The averaging method, therefore, by which all sizes of children's underwear of a particular style had been sold at the same price, had been changed to one by which sizes bore different prices based on cost. The variations in costs between the sizes in boys', misses', men's, and women's garments were by no means negligible, although they generally were less than the variations in the costs of children's garments.

So far as was known, no competitor had made the change in price policy proposed by the treasurer of the Fox Mills. There was the possibility, consequently, that the innovation would not be received favorably by the company's customers and that sales would be affected adversely. Cataloging and pricing would be complicated, so that price changes would entail more clerical work than was necessary under the method in use.

On the other hand, the company was working toward standardization; it recently had discontinued manufacturing several slow-selling styles. It was suggested that perhaps the proposed price policy would aid in standardization by encouraging the purchase of the cheaper types of garments. For example, the company made a light weight summer garment with a high neck because of the demand of a few customers, and it was expected that a price differential in most cases would cause those customers to change to the more popular low-neck style. Eventually such a price policy should shift sales to the styles which could be manufactured most economically and, consequently, the Fox Mills would have a price advantage unless competitors made similar changes in their policies.

Commentary: The method which the company used in pricing underwear amounted to the application of a standard rate of mark-up to the average mill cost for each style of underwear, weighted according to the estimated sales of each size or finish of that style. Taking the example that is cited of style number 673, the average cost per dozen garments was \$5.70, and the mark-up of \$2.10 was approximately 37% of the cost or 27% of the selling price. The method which the mill used of applying the mark-up did not alter the fact that it amounted to the application of a standard rate to the average weighted mill cost.

The mark-ups in dollars and cents, however, were very different for the three types of garment included in style number 673. For the garments which cost \$6.82 per dozen, the mark-up was 98 cents; for those which cost \$5.83, the mark-up was \$1.97; and for those which cost \$3.04, the mark-up was \$4.76.

Two alternative methods of pricing the underwear suggest themselves. The standard percentage of mark-up might have been applied to the actual mill cost of each size and finish. This would have yielded the same aggregate mark-up in dollars on the entire quantity as was yielded by the method the company was using; neither the selling price nor the mark-up in dollars would have been the same for all finishes and sizes. If the standard rate of 37% of cost had been used for determining the mark-up on each of the three finishes of style number 673, the mark-up on the high-neck garments, which cost \$6.82, would have been \$2.52 and the selling price, therefore, would have been \$9.34; for the Dutch neck garments, which cost \$5.83, the mark-up would have been \$2.16 and the selling price, \$7.99; for the band-top necks, which cost \$3.04, the mark-up at the standard rate would have been \$1.12 and the selling price \$4.16.

The second alternative would have been to apply a flat mark-up in dollars to the actual cost of each size and finish. If the average mark-up of \$2.11 had been applied to each dozen garments, the selling price of the high-neck garments would have been \$8.93; of the Dutch necks, \$7.94; and of the band-tops, \$5.15. The total mark-up in dollars for 10,000 garments would have been the same as under the plan which the company used.

The problem was essentially one of joint cost. The indirect labor costs, the general management expenses, and the selling expenses were incurred jointly for all the products, and the company's decision on the method of apportioning the mark-up should have depended primarily on the strategy of price-making for merchandising purposes. From the merchandising standpoint, the company's problem of making differentiations in prices in accordance with differences in cost was twofold. In the first place, there was the question as to whether different prices

should have been placed on different sizes of a particular style and finish; and in the second place, there was the question as to whether prices for a particular size should have been varied according to length of sleeve and leg and type of neck.

As between sizes, differences in price would not have influenced demand, for the choice of size does not depend on price. In advertising prices to consumers, it would have been awkward for retailers to quote different prices for different sizes of underwear without diverting attention from the qualities of the merchandise; to the manufacturer no gain would have accrued from quoting different prices for different sizes that would have been commensurate with the extra expense of using a more complicated price scale.

Consumers' preferences for underwear of various lengths of legs and sleeves and heights of necks were influenced chiefly by reasons of personal comfort or of style, style probably being more important in the selection of women's garments than in the selection of men's and children's garments. From the merchandising standpoint, it was not desirable to induce consumers to purchase short-sleeve, short-leg, or low-neck garments merely because of a difference in price if thereby the consumers secured less comfort. In so far as the garments were purchased for style reasons, moreover, a difference in price was not a strong factor in influencing sales.

Where style was the predominant factor influencing selection of height of neck, for example, different prices readily could have been placed on different heights of neck. Even in that case, however, the prices should not have been based entirely on differences in costs. The strength of demand also should have been reckoned with in the distribution of joint costs. The garments with the strongest style characteristics could have borne a higher mark-up, and consequently a larger share of the joint costs, than was placed on the more staple, less stylish garments. This result was attained by the method used by the Fox Mills. Despite the differences in costs, therefore, it apparently would not have been wise for the company to try to divert consumers' purchases from one length of sleeve or leg or one height of neck to another by means of price variations.

It seems to have been desirable for the company to adhere to its practice of quoting a uniform price for the various sizes and finishes of the garments of each style number. That practice was simplest from the administrative standpoint and it appears to have apportioned joint costs in a manner which was likely to be conducive to success from the merchandising standpoint.

November, 1925 M. T. C.

Crowley Company[1]

MANUFACTURER—SHINGLES

Pricing—*Determination of Price for New Product.* The company planned to manufacture and market colored asphalt shingles superior in appearance to any colored asphalt shingles then on the market. The company decided to set the wholesale prices for the new shingles in line with the lowest prices charged by competitors for similar shingles. Those prices would allow the company a gross margin equal to its gross margin on uncolored shingles, so that its profits would not be reduced if consumers substituted colored for uncolored shingles.

(1924)

The Crowley Company, of Elizabeth, New Jersey, manufactured asphalt roll roofing, shingles, felt, coating, water-proof paper, cement, plastic, and paint. In May, 1924, after extensive experiments, the company began to produce in quantity a new type of colored asphalt shingles. The president directed the sales manager to set a selling price on the new product; the company did not attempt to stipulate resale prices.

The company, which was one of the leaders in the industry, maintained factories at Elizabeth, and at St. Louis, Missouri. Branch sales offices were located at New York, Chicago, and St. Louis. Since the company's products were cheap in comparison with their bulk, freight charges were an important factor in the determination of total costs to purchasers, and the company was unable to sell its products west of the Rocky Mountains. It sold throughout the remainder of the United States, however, to wholesalers of building materials, hardware wholesalers, large retailers, and large industrial companies. The company maintained a staff of 43 salesmen, who called on all its customers and also on contractors and architects.

The company's terms were 2% 10 days, net 30 days. On 12 of its products the company allowed an 8% discount to wholesalers and on 2 others it allowed a discount of 6%. These same discounts also were offered to all other customers who purchased at least 20 carloads from the company during a year. The dis-

[1] Fictitious name.

counts were based on carload prices; prices on less-than-carload lots were from 4% to 12% higher than the carload prices.

The company made plain, uncolored asphalt shingles which were similar in many respects to the colored shingles. Both products were made on the same machines, although the manufacture of the colored shingles required several additional attachments. The coloring was somewhat more costly than the coating of the plain shingles. During the first part of 1924, the average factory cost of the plain shingles was about $3.50 a square. A square comprised 108 square feet. The list price of the plain shingles to purchasers of carload lots was $5.05 a square, and to purchasers of less-than-carload lots, $5.61 a square. A discount of 6% from the carload price was allowed to wholesalers and to 20 large retailers. The company's average gross margin on this line, in the same period, was approximately 32% of net sales. The average total selling cost, including sales commissions and administrative and general office overhead, was 20% of net sales. The average net profit on the line, therefore, approximated 12%. The percentage of selling expense was about the same for all products of the company. The company's average net profit for the business as a whole ranged from 8% to 10% of sales. The company estimated that after several months the factory cost of the colored shingles would be $3.80 a square. The cost was expected to be somewhat higher temporarily, because the workmen were not familiar with the process for making the new product.

Several competitors of the Crowley Company also manufactured colored shingles. The competitive shingles when placed upon roofs gave the appearance of blotches rather than of a uniform color, while the coloring of the shingles of the Crowley Company was so blended as to produce a monotone effect. The sales prices of the colored shingles of competitors varied from 50 cents to $1 a square above the wholesale prices of the company's uncolored, asphalt shingles.

If the company set the prices for the colored shingles in line with the highest price which was received by competitors for a similar product, the gross margin on the line would be 37%, and the average net profit of the company would be earned immediately. Since it was not possible to estimate accurately the

demand for the colored shingles, stocks might be built up which could not be sold except at a loss; it was the custom of the company to manufacture for stock and not upon special orders. The quality of the colored shingles was to be differentiated sharply from that of the uncolored shingles. A higher price would emphasize the higher quality.

On the other hand, if the company decided to charge prices in line with the highest prices charged for similar products by competitors, it might have difficulty in meeting competition except in the territories near its factories, where the freight differential would give it an advantage. High selling prices, the sales manager believed, would tend to cause a continuation of the high costs incident to a new process. If the sales manager could show to the production department that the net profit on a line was lower than the average for the company, he had a good basis for demanding a reduction in costs. With the prices $1 above the selling prices of the uncolored shingles, the net profit would be above the average for the whole factory. In the opinion of the sales manager, these prices for the colored shingles would restrict sales of that item, regardless of prices of competitors. He believed that the average builder would buy the company's ordinary asphalt shingles rather than pay the price differential which would exist between these shingles and the colored shingles if the company asked the highest price asked by competitors for similar products.

The sales manager estimated that wholesale prices of about $5.25 a square for carload lots and of about $5.78 a square for less-than-carload lots would give a net profit on the line approximately equal to the company's average net profit of from 8% to 10%. At those prices, it seemed probable that the company's sales of uncolored shingles would be reduced, because the difference in the prices of the two types of shingles would be less than the difference in their factory costs. Since the net profit on the uncolored shingles was 12%, this would result in a loss of profit to the company.

If the prices were set so as to yield ultimately a gross margin of 32%, the same as the gross margin on the uncolored shingles, the sales prices would be in line with the lowest prices charged by competitors; that is, $5.55 a square in carload lots, and $6.10

in less-than-carload lots. The cost differential between uncolored and colored shingles would be maintained in the prices of the two types. The sales manager did not believe that with this differential there would be any substitution of uncolored shingles for colored shingles by those who desired the latter. The advantage which the company would gain over the competitors who charged higher prices would assist it to build up a demand for the product.

The sales manager decided to price the colored shingles at $5.55 a square in carload lots, and at $6.10 a square in less-than-carload lots. He concluded that a much larger quantity would be sold at those prices than at the higher prices, and that the sales of the uncolored shingles would not be decreased materially. Even if buyers substituted the colored for the uncolored shingles, the profits of the company would not be reduced. The sales manager believed that he would be able to force a quick reduction in the factory costs of the product.

Commentary: In deciding upon the price to place upon the new product, colored shingles, the company faced two major considerations besides the immediate net profit to be realized. The first consideration was the effect which the price placed on colored shingles would have on the sales of uncolored shingles; the second was the merits of the price from the standpoint of selling strategy.

Inasmuch as the colored shingles which this company was to market had a monotone appearance superior to that of other colored asphalt shingles on the market, it was impossible to determine in advance, from experience with these competitive shingles, how extensively the company's colored shingles would be substituted for uncolored shingles, either at a price differential of 20 cents a square or at a differential of 50 cents a square. The substitution of colored for uncolored shingles by consumers would not be governed by differences in manufacturing costs, but by the degree to which the buying motives of pride in appearance of property and, perhaps, expression of artistic taste surpassed the desire for economy. Under these circumstances the sales manager followed a safe course in deciding upon a price differential of 50 cents a square, which assured the company of a normal net profit even if the colored shingles were extensively substituted for uncolored shingles.

From the standpoint of sales strategy, the selection of the $5.55 price also was advantageous. It met the lowest price of directly competitive shingles. This afforded the company an opportunity to stress the buy-

ing motives pertaining to the appearance of its product, with incidental reference to price. Those motives pertained to qualities which could be judged effectively by consumers in advance of purchase. When those motives were backed up by the opportunity to purchase the Crowley Company's shingles at a price as low as those charged for competing shingles, the company was in a strong strategic position.

April, 1926 M. T. C.

Kronin Manufacturing Company[1]

MANUFACTURER—SILVER PENCILS

Price Maintenance—*Acceptance of Returned Goods to Prevent Price-Cutting.* During a general business depression a wholesale customer of the company asked to be permitted to return a large stock of silver pencils which he had purchased from the company in a period of active sales. The company had endeavored to secure observance of standardized resale prices for its products. Unless the company accepted the return goods, it was probable that the wholesaler would cut the resale prices on the pencils in order to sell them quickly.

(1921)

During the general business depression in 1921 the Kronin Manufacturing Company received a request from the Howard Hardware Company,[1] one of its largest wholesale customers in the Middle West, to accept the return of $20,000 worth of silver pencils which the wholesaler had on hand as a result of overordering in a period of active sales.

The Kronin Manufacturing Company had been one of the first companies to manufacture silver, propelling pencils. From the beginning the company had endeavored to secure observance of standardized wholesale and retail selling prices for its products. The suggested retail price of its standard pencils was $1.25 each; the retail prices of other models were proportionate. The company's sales had grown rapidly and in 1920 aggregated $4,000,000. During the first six months of 1921, however, total sales were only $1,150,000. The company had not attempted to bind its customers by contract to maintain resale prices, but its advertising had featured the retail prices prominently, and its salesmen had been instructed to endeavor to make the customers realize that it was to their advantage to sell at uniform prices. So far as the Kronin Manufacturing Company knew, the resale prices of its pencils seldom were cut, even during periods of declining prices.

The Howard Hardware Company had purchased $35,000 worth of silver pencils from the Kronin Manufacturing Company in 1919 and $50,000 worth in 1920. In requesting permission to

[1] Fictitious name.

return $20,000 worth of goods, Mr. Howard, president of the company, stated that his company was in financial difficulty, but that if it could liquidate enough of its inventory it could meet the situation. He intimated that if the goods were not accepted by the Kronin Manufacturing Company he would be forced to sell them, together with other goods on his shelves, at whatever prices they would bring.

The executives of the Kronin Manufacturing Company realized that price-cutting by such a large firm would become known immediately and might initiate a wide-spread reduction in the selling prices of Kronin pencils. Such a step, the executives were aware, might undo the company's efforts to maintain resale prices. The Kronin Manufacturing Company had adequate resources to care for its own financing during the depression. A refund of $20,000, however, would reduce the current funds of the company materially. Compliance with the request of the Howard Hardware Company might precipitate similar requests from other customers.

The situation was complicated, moreover, by the fact that competition of cheaper pencils was beginning to affect sales of Kronin pencils. The executives had considered seriously reducing the retail price of the standard pencils to $1 each. The sales manager was willing for the Howard Hardware Company to make a 20% reduction in the prices of the pencils it had on hand, but he realized that, in view of market conditions, even that price concession would not be sufficient to move the Howard Hardware Company's large stock of pencils promptly.

COMMENTARY: In this case evidence is lacking as to the relations between the company and its wholesale customers, as to the company's methods of inducing retailers to observe the standard resale prices, as to the margins allowed to wholesalers and retailers, and as to the extent of stocks in the hands of other wholesalers and of retailers at the time the Howard Hardware Company made its request.

As far as can be judged from the evidence available, however, it was imperative for the Kronin Manufacturing Company to accept the return of merchandise from the Howard Hardware Company unless the manufacturing company was to permit its plan of standardizing resale prices to be jeopardized. A customer with an excess stock of merchandise on hand must be permitted either to return the excess quantity to

the vendor or to liquidate the stock at prices fixed at his own discretion. In this case such liquidation probably would have rendered the restoration of the company's standardized resale price plan difficult.

If the Kronin Manufacturing Company had permitted the Howard Hardware Company to reduce the prices of Kronin pencils 20%, another problem would have been precipitated—as to whether the manufacturer should have granted rebates to wholesalers and retailers to the amount of 20% of the purchase value of their stocks of Kronin pencils on hand. Merchants who had bought the pencils in conservative quantities and in confidence that resale prices would be maintained might have looked upon a 20% reduction in suggested resale prices, without prior warning, as a breach of faith by the Kronin Manufacturing Company unless rebates were granted on stocks on hand.

If the Howard Hardware Company had been permitted to return such a large quantity of merchandise, it would have been necessary for the Kronin Manufacturing Company in fairness to extend the same privilege to other customers under similar circumstances. Thus the company's contingent liabilities would have been increased indefinitely.

This case illustrates some of the difficulties which accompany a plan of standardizing resale prices. For the successful operation of such a plan, it clearly is essential that overbuying by customers be guarded against.

April, 1926 M. T. C.

United States *v.* Colgate & Company[1]

MANUFACTURER—TOILET ARTICLES

Price Maintenance—*Right of Manufacturer to Refuse to Sell to Price-Cutters Upheld.* The duty of the Supreme Court of the United States in this case was not to pass upon the legality of the methods used by the company to maintain standard resale prices for the soap and other toilet articles which it manufactured, but to determine whether the indictment as interpreted by the trial court fairly charged violation of the Sherman Act. The court concluded that, so interpreted, the indictment merely charged the company with specifying resale prices and refusing to deal with any one who failed to maintain them, and affirmed that in the absence of any purpose to create or maintain a monopoly the Sherman Act did not restrict the right of a manufacturer engaged in a private business to refuse to sell to any one for any cause and to announce in advance conditions under which he would refuse to sell.[2]

(1919)

Mr. Justice McReynolds delivered the opinion of the Court.

Writs of error from District Courts directly here may be taken by the United States "from a decision or judgment quashing, setting aside, or sustaining a demurrer to, any indictment, or any count thereof, where such decision or judgment is based upon the invalidity, or construction of the statute upon which the indictment is founded." Act March 2, 1907, *c.* 2564, 34 Stat. 1246 (Comp. St. § 1704). Upon such a writ "we have no authority to revise the mere interpretation of an indictment and are confined to ascertaining whether the court in a case under review erroneously construed the statute." "We must accept that court's interpretation of the indictments and confine our review to the question of the construction of the statute involved in its decision." *United States* v. *Carter,* 231 U. S. 492, 493, 34 Sup. Ct. 173, 174 (58 L. Ed. 330); *United States* v. *Miller,* 223 U. S. 599, 602, 32 Sup. Ct. 323, 324 (56 L. Ed. 568).

Being of the opinion that "the indictment should set forth such a state of facts as to make it clear that a manufacturer, engaged in what was believed to be the lawful conduct of its business, has violated some known law before it can be haled into court to answer the charge of a commission of crime," and holding that it "fails to charge any offense under the Sherman Act [Act July 2, 1890, *c.* 647, 26 Stat. 209] or any other law of the United States, that is to say, as to the substance of the indictment and the conduct and act charged therein," the trial court

[1] Supreme Court of the United States. Argued March 10, 1919. Decided June 2, 1919. 39 Sup. Ct. 465. 250 U. S. 300.

[2] Headnote by Graduate School of Business Administration.

sustained a demurrer to the one before us. Its reasoning and conclusions are set out in a written opinion. 253 Fed. 522.

We are confronted by an uncertain interpretation of an indictment itself couched in rather vague and general language. Counsel differ radically concerning the meaning of the opinion below and there is much room for the controversy between them.

The indictment runs only against Colgate & Company, a corporation engaged in manufacturing soap and toilet articles and selling them throughout the Union. It makes no reference to monopoly, and proceeds solely upon the theory of an unlawful combination. After setting out defendant's organization, place and character of business, and general methods of selling and distributing products through wholesale and retail merchants, it alleges:

> During the aforesaid period of time, within the said Eastern district of Virginia and throughout the United States, the defendant knowingly and unlawfully created and engaged in a combination with said wholesale and retail dealers, in the Eastern district of Virginia and throughout the United States, for the purpose and with the effect of procuring adherence on the part of such dealers (in reselling such products sold to them aforesaid) to resale prices fixed by the defendant, and of preventing such dealers from reselling such products at lower prices, thus suppressing competition amongst such wholesale dealers, and amongst such retail dealers, in restraint of the aforesaid trade and commerce among the several States, in violation of the act entitled "An act to protect trade and commerce against unlawful restraints and monopolies," approved July 2, 1890.

Following this is a summary of things done to carry out the purposes of the combination: Distribution among dealers of letters, telegrams, circulars and lists showing uniform prices to be charged; urging them to adhere to such prices and notices, stating that no sales would be made to those who did not; requests, often complied with, for information concerning dealers who had departed from specified prices; investigation and discovery of those not adhering thereto and placing their names upon "suspended lists"; requests to offending dealers for assurances and promises of future adherence to prices, which were often given; uniform refusals to sell to any who failed to give the same; sales to those who did; similar assurances and promises required of, and given by, other dealers followed by sales to them; unrestricted sales to dealers with established accounts who had observed specified prices, and so forth.

Immediately thereafter comes this paragraph:

> By reason of the foregoing, wholesale dealers in the aforesaid products of the defendant in the Eastern district of Virginia and throughout the United States, with few exceptions, resold, at uniform prices fixed by the defendant, the aforesaid products, sold

to them by the defendant, and refused to resell such products at lower prices to retail dealers in the state where the respective wholesale dealers did business and in other states. For the same reason retail dealers in the aforesaid products of the defendant in the Eastern district of Virginia and throughout the United States resold, at uniform prices fixed by the defendant, the aforesaid products, sold to them by the defendant and by the aforesaid wholesale dealers, and refused to sell such products at lower prices to the consuming public in the states where the respective retail dealers did business and in other states. Thus competition in the sale of such products, by wholesale dealers to retail dealers, and by retail dealers to the consuming public, was suppressed, and the prices of such products to the retail dealers and to the consuming public in the Eastern district of Virginia and throughout the United States were maintained and enhanced.

In the course of its opinion the trial court said:

No charge is made that any contract was entered into by and on the part of the defendant, and any of its retail customers, in restraint of interstate trade and commerce, the averment being, in effect, that it knowingly and unlawfully created and engaged in a combination with certain of its wholesale and retail customers, to procure adherence on their part, in the sale of its products sold to them, to resale prices fixed by the defendant, and that, in connection therewith, such wholesale and retail customers gave assurances and promises, which resulted in the enhancement and maintenance of such prices, and in the suppression of competition by wholesale dealers and retail dealers, and by the latter to the consuming public. . . . .

In the view taken by the court, the indictment here fairly presents the question of whether a manufacturer of products shipped in interstate trade, is subject to criminal prosecution under the Sherman Act, for entering into a combination in restraint of such trade and commerce, because he agrees with his wholesale and retail customers, upon prices claimed by them to be fair and reasonable, at which the same may be resold, and declines to sell his products to those who will not thus stipulate as to prices. This, at the threshold, presents for the determination of the court, how far one may control and dispose of his own property; that is to say, whether there is any limitation thereon, if he proceeds in respect thereto in a lawful and bona fide manner. That he may not do so, fraudulently, collusively, and in unlawful combination with others, may be conceded. *Eastern States Retail Lumber Dealers' Association* v. *United States,* 234 U. S. 600, 614, 34 Sup. Ct. 951, 58 L. Ed. 1490, L. R. A. 1915A, 788. But it by no means follows that being a manufacturer of a given article, he may not, without incurring any criminal liability, refuse absolutely to sell the same at any price, or to sell at a named sum to a customer, with the

understanding that such customer will resell only at an agreed price between them, and should the customer not observe the understanding as to retail prices, exercise his undoubted right to decline further to deal with such person. . . . .

The pregnant fact should never be lost sight of that no averment is made of any contract or agreement having been entered into whereby the defendant, the manufacturer, and his customers, bound themselves to enhance and maintain prices, further than is involved in the circumstances that the manufacturer, the defendant here, refused to sell to persons who would not resell at indicated prices, and that certain retailers made purchases on this condition, whereas, inferentially, others declined so to do. No suggestion is made that the defendant, the manufacturer, attempted to reserve or retain any interest in the goods sold, or to restrain the vendee in his right to barter and sell the same without restriction. The retailer, after buying, could, if he chose, give away his purchase or sell it at any price he saw fit, or not sell it at all, his course in these respects being affected only by the fact that he might by his action incur the displeasure of the manufacturer who could refuse to make further sales to him, as he had the undoubted right to do. There is no charge that the retailers themselves entered into any combination or agreement with each other, or that the defendant acted other than with his customers individually.

Our problem is to ascertain, as accurately as may be, what interpretation the trial court placed upon the indictment—not to interpret it ourselves; and then to determine whether, so construed, it fairly charges violation of the Sherman Act. Counsel for the government maintain, in effect, that, as so interpreted, the indictment adequately charges an unlawful combination (within the doctrine of *Dr. Miles Medical Co.* v. *Park & Sons Co.*, 220 U. S. 373, 31 Sup. Ct. 376, 55 L. Ed. 502) resulting from restrictive agreements between defendant and sundry dealers whereby the latter obligated themselves not to resell except at agreed prices, and to support this position they specifically rely upon the above-quoted sentence in the opinion which begins, "In the view taken by the court," and so forth. On the other hand, defendant maintains that looking at the whole opinion it plainly construes the indictment as alleging only recognition of the manufacturer's undoubted right to specify resale prices and refuse to deal with any one who failed to maintain the same.

Considering all said in the opinion (notwithstanding some serious doubts) we are unable to accept the construction placed upon it by the government. We cannot, e. g., wholly disregard the statement that—

The retailer, after buying, could, if he chose, give away his purchase or sell it at any price he saw fit, or not sell it at all, his course in these respects being affected only by the fact that he might by his action incur the displeasure of the manufacturer who could

refuse to make further sales to him, as he had the undoubted right to do.

And we must conclude that, as interpreted below, the indictment does not charge Colgate & Company with selling its products to dealers under agreements which obligated the latter not to resell except at prices fixed by the company.

The position of the defendant is more nearly in accord with the whole opinion and must be accepted. And as counsel for the Government were careful to state on the argument that this conclusion would require affirmation of the judgment below, an extended discussion of the principles involved is unnecessary.

The purpose of the Sherman Act is to prohibit monopolies, contracts and combinations which probably would unduly interfere with the free exercise of their rights by those engaged, or who wish to engage, in trade and commerce—in a word, to preserve the right of freedom to trade. In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal; and, of course, he may announce in advance the circumstances under which he will refuse to sell. "The trader or manufacturer, on the other hand, carries on an entirely private business, and can sell to whom he pleases." *United States* v. *Trans-Missouri Freight Association,* 166 U. S. 290, 320, 17 Sup. Ct. 540, 551, (41 L. Ed. 1007). "A retail dealer has the unquestioned right to stop dealing with a wholesaler for reasons sufficient to himself, and may do so because he thinks such dealer is acting unfairly in trying to undermine his trade."[3]

In *Dr. Miles Medical Co.* v. *Park & Sons Co., supra,* the unlawful combination was effected through contracts which undertook to prevent dealers from freely exercising the right to sell.

The judgment of the District Court must be

Affirmed

COMMENTARY: The court in this decision said: "Our problem is to ascertain, as accurately as may be, what interpretation the trial court placed upon the indictment—not to interpret it ourselves; and then to determine whether, so construed, it fairly charges violation of the Sherman Act." This decision, therefore, was primarily upon the interpretation of the indictment by the trial court, not upon the legality of the methods used by Colgate & Company to induce observance of its

[3] *Eastern States Retail Lumber Dealers' Association* v. *United States,* 234 U. S. 600, 614, 34 Sup. Ct. 951, 955 (58 L. Ed. 1490, L. R. A. 1915A, 788). See also *Standard Oil Co.* v. *United States,* 221 U. S. 1, 56, 31 Sup. Ct. 502, 55 L. Ed. 619, 34 L. R. A. (N. S.) 834, Ann. Cas. 1912D, 734; *United States* v. *American Tobacco Co.,* 221 U. S. 106, 180, 31 Sup. Ct. 632, 55 L. Ed. 663; *Boston Store of Chicago* v. *American Graphophone Co. et al.,* 246 U. S. 8, 38 Sup. Ct. 257, 62 L. Ed. 551, Ann. Cas. 1918C, 447.

suggested resale prices. The company suggested resale prices, employed moral suasion to secure observance of them, and if unsuccessful in preventing price-cutting by that means, refused to sell further quantities of merchandise to the price-cutters. The legality of these methods of maintaining resale prices was not passed upon by the court in this decision.

It obviously is not within my province to discuss the decision as to the interpretation of the indictment. That was a technical legal question, not a business matter. The decision in this case threw no light on the court's attitude toward the use of moral suasion and the refusal to sell to price-cutters as a means of securing the observance of standard resale prices. The court indicated that, in the absence of any purpose to create and maintain a monopoly, a manufacturer engaged in an entirely private business may exercise freely his discretion as to whom to sell to and may announce in advance the conditions under which he will sell. Such methods as were used by Colgate & Company, therefore, seem to have been legal provided there was no purpose to create and maintain a monopoly. Yet no guidance is provided in this decision as to what factors would be held by the court as indicating a "purpose to create and maintain a monopoly."

That the methods used by Colgate & Company, without written contracts to bind its customers to observe the stipulated resale prices, were likely, nevertheless, to result in a general observance of those prices, there can be no doubt. In the light of previous decisions by the court, it is altogether uncertain whether the court would have held these practices, under the circumstances, to indicate an attempt to create and maintain a monopoly, if such a purpose had been charged in the indictment. If the question were approached, however, from the standpoint of sound business management, with clear comprehension of sane merchandising methods, it would be apparent that the maintenance of resale prices by the means employed by Colgate & Company did not partake of the nature of monopoly.[4]

June, 1926 M. T. C.

[4] See Copeland, Melvin T., "Standardized Resale Prices," *Harvard Business Review,* Vol. IV, No. 4, July, 1926, pp. 393-406.

Federal Trade Commission *v.* Beech-Nut Packing Company[1]

MANUFACTURER—FOOD PRODUCTS

Price Maintenance—*Standardization of Resale Prices by Cooperative Means Held Illegal.* The company, which manufactured and sold to wholesalers food and other products, endeavored to maintain the standard resale prices of its goods. The Supreme Court of the United States decided that the company should be required to discontinue its efforts to maintain resale prices: by obtaining from salesmen, agents, or distributors the names of price-cutters; by maintaining lists of wholesalers and retailers to whom sales of the products were not to be made; by refusing to give orders secured by missionary salesmen for wholesalers' accounts to wholesalers who sold at cut prices or who sold to price-cutters; by utilizing identifying marks on packages of merchandise to trace the sources of purchase of goods sold at cut prices; or by utilizing any other equivalent cooperative means.[2]

Price Maintenance—*Methods Held to Constitute Unfair Competition.* The company, which manufactured food and other products, selling them chiefly to wholesalers, endeavored to maintain standard resale prices for its products by obtaining information as to price-cutters and refusing to sell to wholesalers who cut the prices or who sold to price-cutters. The Supreme Court of the United States decided that, since the methods employed by the company served to prevent competition in its products among retailers, the company was guilty of unfair trading within the meaning of the Federal Trade Commission Act.[2]

(1922)

Mr. Justice Day delivered the opinion of the Court:

This case is here upon a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit, which court set aside an order of the Federal Trade Commission requiring the Beech-Nut Packing Company, a corporation engaged in the manufacture and sale of food and other products throughout the United States, to cease and desist from carrying out a plan of resale of its products.[3] *Beech-Nut Packing Company* v. *Federal Trade Commission,* 264 Fed. 885.

[1] Supreme Court of the United States. Argued November 10-14, 1921. Decided January 3, 1922. 42 Sup. Ct. 150. 257 U. S. 441.

[2] Headnote by Graduate School of Business Administration.

[3] "Now, therefore, it is ordered that respondent, the Beech-Nut Packing Company, its officers, directors, agents, servants, and employees cease and desist from directly or indirectly recommending, requiring, or by any means bringing about the resale of Beech-Nut products by distributors, whether at wholesale or retail according to any system of prices fixed or established by respondent, and more particularly by any or all of the following means:

The Commission condemned the plan as an unfair method of competition within the meaning of section 5 of the Federal Trade Commission Act. 38 Stat. 719 (Comp. St. § 8836*e*).

In the original complaint it was charged that in order to accomplish the illegal purpose intended the Beech-Nut Company required its purchasers to agree to maintain or resell such products at standard selling prices, and that for the purpose of maintaining such standard resale prices and for the purpose of inducing and compelling its customers to maintain and keep such standard prices the company refused to sell its products to customers and dealers who would not agree to maintain such specified standard resale prices, and who did not resell such products at the specified standard selling prices fixed and determined by the company. By stipulation before trial the complaint was amended so as to charge: That the Beech-Nut Company has adopted and enforced a system of fixing and maintaining certain specified standard prices at which its chewing gum and food products shall be resold by purchasers thereof, including jobbers, wholesalers, and retailers, with the purpose and effect of securing the trade of such jobbers, wholesalers, and retailers and of enlisting their active support and cooperation in enlarging the sale of respondent's products, to the prejudice of its competitors who do not require and enforce the maintenance of resale prices for their products; and with the purpose and effect of eliminating competition in prices among all jobbers, wholesalers, and retailers, respectively, engaged in handling the products manufactured by the company, thereby depriving such distributors of their right to sell, and preventing them from selling its products at such prices as they may deem to be, and as are, adequate and warranted by their respective selling costs and efficiency, and with various other effects, and that the company as a means of making effective its system of resale prices and of inducing and compelling its customers and the dealer customers of its customers to maintain such resale prices, has for more than two years last past: Made it generally know to jobbers, wholesalers, and retailers, respectively, that it required and insisted that they should sell its products at the resale prices so fixed by it, and refused to sell to jobbers, wholesalers, or retailers not maintaining such prices; that the company threatened to and did refuse to sell to all jobbers, wholesalers, and retailers who failed to maintain the resale prices so fixed by it, or who sold to other distributors who failed to maintain such prices; induced or compelled

"1. Refusing to sell to any such distributors because of their failure to adhere to any such system of resale prices.

"2. Refusing to sell to any such distributors because of their having resold respondent's said products to other distributors who have failed to adhere to any such system of resale prices.

"3. Securing or seeking to secure the cooperation of its distributors in maintaining or enforcing any such system of resale prices.

"4. Carrying out or causing others to carry out a resale price maintenance policy by any other means."

the jobbers, wholesalers, and retailers, by divers other means, not only to maintain its resale prices so fixed, but also to discontinue selling its products to other jobbers, wholesalers, and retailers who did not maintain such resale prices; that the company caused the diversion of retailers' orders away from jobbers and wholesalers who did not maintain such resale prices so fixed by it, or who had resold its products to other jobbers, wholesalers, or retailers who had failed to maintain such resale prices, and caused such orders to be given to other jobbers and wholesalers who had maintained such resale prices and/or had refused to supply other jobbers, wholesalers, and retailers failing to maintain such prices; that the company solicited and secured the cooperation of wholesalers, jobbers, and retailers in reporting price-cutters, all in pursuance of its efforts to ascertain the names of all distributors of its products who had failed to maintain the resale prices fixed by it, and/or who had resold to other jobbers, wholesalers, and retailers failing to maintain such prices; that it entered in card records kept by it the names of all dealers reported to it, either in this or other ways, as not maintaining its resale prices or as selling to other distributors not maintaining such prices, and has taken various measures to prevent all such dealers from obtaining further shipments of its products from any source until it has received from them declarations, promises, assurances, statements, or other similar expressions, to the effect that in the future such dealers intend to and will sell such products at the resale prices fixed by the company and will refrain from selling the same to other jobbers, wholesalers, and retailers failing to maintain such prices; that respondent employed various other means and methods for the enforcement of its system of maintaining resale prices.

The case was heard before the Commission upon an agreed statement of facts, from which, among other things, it found:

The Beech-Nut Packing Company customarily markets its products principally through jobbers and wholesalers in the grocery, drug, candy and tobacco lines, who in turn resell to retailers in these lines. Such wholesale and retail dealers are selected as desirable customers because they are known or believed to be of good credit standing; willing to resell at the resale prices suggested by the company and who do resell at such prices; are willing to refuse to sell and who do refuse to sell to jobbers, wholesalers, and retailers who do not resell at the resale prices suggested by the company, and who do not sell to such jobbers, wholesalers, and retailers, who in other respects are good and satisfactory merchandisers. Such jobbers, wholesalers and retailers are designated by the company as "selected" or "desirable" dealers. In a few instances the company also sells "direct" to certain large retailers who are selected as the jobbers, wholesalers and retailers. The total number of such dealers, handling the products of the company, includes the greater portion of the jobbers, wholesalers, and retailers, respectively, in the grocery trades, and a large proportion of the jobbers, wholesalers and retailers in the drug, candy, and tobacco trades respectively, throughout the United States.

The company has adopted and maintained, and still maintained at the time complaint was filed by the Commission, in the sale and distribution of its products a policy known as the "Beech-Nut policy," and requests the cooperation therein of all dealers selling the products manufactured by it, dealing with each customer separately.

In order to secure such cooperation and to carry out the Beech-Nut policy the company:

Issues circulars, price-lists, and letters to the trade generally showing suggested uniform resale prices, both wholesale and retail, to be charged for Beech-Nut products.

Requests and insists that the selected jobbers, wholesalers, and retailers sell only to such other jobbers, wholesalers, and retailers as have been and are willing to resell and do resell at the prices so suggested by the company, and requests and insists that such jobbers, wholesalers and retailers discontinue selling to other jobbers, wholesalers, and retailers who fail to resell at the prices so suggested by the company.

Makes it known broadcast to such selected jobbers, wholesalers and retailers, whether sold "direct" or not, that if they, or any of them fail to sell at the resale prices suggested by the company, it will absolutely refuse to sell further supplies of its product to them, or any of them, and will also absolutely refuse to sell to any jobbers, wholesalers, and retailers whatsoever who sell to other jobbers, wholesalers, and retailers failing to resell at the prices suggested by the company.

The company, in the carrying out of its policy has refused and does refuse to sell its products to practically all such jobbers, wholesalers, and retailers as do not sell at the prices so suggested by it. It has refused and does refuse to sell to practically all such jobbers, wholesalers, and retailers reselling to other jobbers, wholesalers, and retailers who have failed to resell at the prices so suggested by it. It has refused and does refuse to sell to practically all so-called mail-order houses engaged in interstate commerce, on the ground that such mail-order houses frequently sell at cut prices, and has refused and does refuse to sell to practically all jobbers, wholesalers, and retailers who sell its products to such mail-order houses. It has refused and does refuse to sell to practically all so-called price-cutters. It has maintained and does maintain a large force of so-called specialty salesmen or representatives who call upon the retail trade and solicit orders therefrom to be filled through jobbers and wholesalers, which orders are commonly known in the trade as "turnover orders;" its salesmen, under respondent's instructions, have refused and do refuse to accept any such turnover orders to be filled through jobbers and wholesalers who themselves sell or have sold at less than the suggested resale prices, or sell or have sold to jobbers, wholesalers and retailers who sell or have sold at less than such suggested resale prices, and in such cases has requested such retailers to name other jobbers.

The company has and does reinstate as distributors of its products jobbers, wholesalers, and retailers previously cut off or withdrawn from

the list of selected jobbers, wholesalers, and retailers for failure to resell at the prices suggested by it, and for selling to distributors who do not maintain such suggested resale prices, upon the basis of declarations, assurances, statements, promises, and similar expressions, as the case may be by such distributors, respectively, who satisfy the company that such distributors will thereafter resell at the prices suggested by it and will refuse to sell to distributors who do not maintain such suggested resale prices.

The company has added and does add, to its list of new distributors, concerns reported by its representatives as declaring that they intend to and will resell at the prices suggested by it, and will refuse to sell to those who do not maintain such suggested resale prices. It has utilized a system of key numbers or symbols stamped or marked upon the cases containing the "Beech-Nut brand" products, thus enabling it, for any purpose whatsoever, to ascertain the identity of the distributors from whom such products were purchased; and that repeatedly, when instances of price-cutting have been reported to it by the selected wholesalers and retailers, or ascertained in other ways, its salesmen and representatives have been instructed by it to investigate, and that in pursuance of these instructions they have by means of these key numbers or symbols traced the price-cutters from whom the goods have been obtained, and have thus ascertained the identity of such price-cutters, and have also thus traced and ascertained the identity of distributors from whom price-cutters have purchased "Beech-Nut brand" products; and has thereafter refused to supply all such dealers with its products, whether such dealers were themselves cutting the suggested resale prices or were selling to dealers cutting the suggested resale prices.

The company has and does maintain card records containing the names of thousands of jobbing, wholesale, and retail distributors, including the selected distributors, and in furtherance of its refusal to sell goods either to distributors selling at less than the suggested resale prices, or to distributors selling to other distributors selling at less than the suggested resale prices, has listed upon those cards, bearing the names of such distributors, the words "Undesirable—Price-Cutters," "Do Not Sell," or "D.N.S.," the abbreviation for "Do Not Sell," or expressions of a like character, to indicate that the particular distributor was in the future not to be supplied with respondent's goods on account of failure to maintain the suggested resale prices, or on account of failure to discontinue selling to dealers failing to maintain such suggested resale prices. When the company has received declarations, assurances, statements, promises, or similar expressions, as the case may be, by distributors which satisfy it that such distributors will resell at the prices suggested by it, and discontinue selling to distributors failing to maintain the resale prices suggested by it, it has issued instructions to "clear the record," or directions of similar import, notation of which is made on the cards, and it has thereafter permitted shipments of its products to be made to such distributors; and such distributors to whom

shipments are thus allowed to go forward constitute the company's list of so-called "selected" jobbers, wholesalers, and retailers, and no distributor is thus listed on such card record as one to whom goods are allowed to go forward who fails to maintain the resale prices suggested by it or sells to distributors failing to resell at such suggested price; and when a jobber, wholesaler, or retailer is reported as failing to maintain the suggested retail prices, and has been entered in the card records as one to whom shipments should not go forward, respondent notifies those jobbers, wholesalers, and retailers who supply the distributor, of this fact, and also notifies its specialty salesmen, and gives similar notices to such jobbers, wholesalers, and retailers and to its specialty salesmen when reinstatements are made in its list of "selected" jobbers, wholesalers, and retailers.

The Circuit Court of Appeals was of opinion that the only difference between the price-fixing policy condemned as unlawful in *Dr. Miles Medical Company* v. *Park & Sons Company,* 220 U. S. 373, 31 Sup. Ct. 376, 55 L. Ed. 502, and the price-fixing plan embodied in the Beech-Nut policy was that in the former case there was an agreement in writing, while in this case the success or failure of the plan depended upon a tacit understanding with purchasers and prospective purchasers. While it expressed its difficulty in seeing any difference between a written agreement and a tacit understanding in their effect upon the restraint of trade, it, nevertheless, regarded the case as governed by the decision of this court in *United States* v. *Colgate & Company,* 250 U. S. 300, 39 Sup. Ct. 465, 63 L. Ed. 992, 7 A.L.R. 443, and, accordingly, held that the Commission had exceeded its power in making the order appealed from.

The Colgate Case was prosecuted under the Sherman Anti-Trust Act (Comp. St. 8820 *et seq.*) and came to this Court under the Criminal Appeals Act (Comp. St. 1704). We therein held that this Court must accept the construction of the indictment as made in the District Court; and, that upon such construction, the only act charged amounted to the exercise of the right of the trader, or manufacturer, engaged in private business, to exercise his own discretion as to those with whom he would deal, and to announce the circumstances under which he would refuse to sell, and that thus interpreted no act was charged in the indictment which amounted to a violation of the Sherman Act prohibiting monopolies, contracts, combinations, and conspiracies in restraint of interstate commerce.

In the subsequent case of *United States* v. *Schrader's Son, Inc.,* 252 U. S. 85, 40 Sup. Ct. 251, 64 L. Ed. 471, this Court had occasion to deal with a case under the Criminal Appeals Act, wherein there was a charge that a manufacturer sold to manufacturers in several states under an agreement to observe certain resale prices fixed by the vendor—which we held to be a violation of the Sherman Anti-Trust Act. In referring to the Colgate Case we said:

> The court below misapprehended the meaning and effect of the

> opinion and judgment in that cause. We had no intention to overrule or modify the doctrine of *Dr. Miles Medical Company* v. *Park & Sons Company,* where the effort was to destroy the dealers' independent discretion through restrictive agreements. Under the interpretation adopted by the trial court and necessarily accepted by us, the indictment failed to charge that Colgate & Company made agreements, either express or implied, which undertook to obligate vendees to observe specified resale prices; and it was treated as alleging only recognition of the manufacturer's undoubted right to specify resale prices and refuse to deal with anyone who failed to maintain the same.

In the still later case of *Frey & Son* v. *Cudahy Packing Company,* 256 U. S. 208, 41 Sup. Ct. 451, 65 L. Ed. 892, wherein this court again had occasion to consider the subject, it was said of the previous decisions in *United States* v. *Colgate* and *United States* v. *Schrader's Son, Inc., supra:*

> Apparently the former case was misapprehended. The latter opinion distinctly stated that the essential agreement, combination or conspiracy might be implied from a course of dealing or other circumstances.

By these decisions it is settled that in prosecutions under the Sherman Act a trader is not guilty of violating its terms who simply refuses to sell to others, and he may withhold his goods from those who will not sell them at the prices which he fixes for their resale. He may not, consistently with the act, go beyond the exercise of this right, and by contracts or combinations, express or implied, unduly hinder or obstruct the free and natural flow of commerce in the channels of interstate trade.

The Sherman Act is not involved here except in so far as it shows a declaration of public policy to be considered in determining what are unfair methods of competition, which the Federal Trade Commission is empowered to condemn and suppress. The case now before us was begun under the Federal Trade Commission Act which was intended to supplement previous anti-trust legislation. See *Report, No. 597, Senate Committee on Interstate Commerce,* June 13, 1914, 63d Congress, 2d Session. That act declares unlawful "unfair methods of competition" and gives the Commission authority after hearing to make orders to compel the discontinuance of such methods. What shall constitute unfair methods of competition denounced by the act, is left without specific definition. Congress deemed it better to leave the subject without precise definition, and to have each case determined upon its own facts, owing to the multifarious means by which it is sought to effectuate such schemes. The Commission, in the first instance, subject to the judicial review provided, has the determination of practices which come within the scope of the act. See *Report, No. 597, Senate Committee on Interstate Commerce,* June 13, 1914, 63d Congress, 2d Session.

Of the Federal Trade Commission Act we said, in *Federal Trade Commission* v. *Gratz,* 253 U. S. 421, 427, 40 Sup. Ct. 572, 575 (64 L. Ed. 993):

> The words "unfair method of competition" are not defined by the statute and their exact meaning is in dispute. It is for the courts, not the Commission, ultimately to determine as matter of law what they include. They are clearly inapplicable to practices never heretofore regarded as opposed to good morals because characterized by deception, bad faith, fraud or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or create monopoly. The act was certainly not intended to fetter free and fair competition as commonly understood and practiced by honorable opponents in trade.

If the "Beech-Nut system of merchandising" is against public policy, because of "its dangerous tendency unduly to hinder competition or to create monopoly," it was within the power of the Commission to make an order forbidding its continuation. We have already seen to what extent the declaration of public policy, contained in the Sherman Act, permits a trader to go. The facts found show that the Beech-Nut system goes far beyond the simple refusal to sell goods to persons who will not sell at stated prices, which in the Colgate Case was held to be within the legal right of the producer.

The system here disclosed necessarily constitutes a scheme which restrains the natural flow of commerce and the freedom of competition in the channels of interstate trade which it has been the purpose of all the Anti-Trust Acts to maintain. In its practical operation it necessarily constrains the trader, if he would have the products of the Beech-Nut Company, to maintain the prices "suggested" by it. If he fails so to do, he is subject to be reported to the company either by special agents, numerous and active in that behalf, or by dealers whose aid is enlisted in maintaining the system and the prices fixed by it. Furthermore, he is enrolled upon a list known as "Undesirable—Price-Cutters," to whom goods are not to be sold, and who are only to be reinstated as one whose record is "clear" and to whom sales may be made upon his giving satisfactory assurance that he will not resell the goods of the company except at the prices suggested by it, and will refuse to sell to distributors who do not maintain such prices.

From this course of conduct a court may infer—indeed, cannot escape the conclusion—that competition among retail distributors is practically suppressed for all who would deal in the company's products are constrained to sell at the suggested prices. Jobbers and wholesale dealers who would supply the trade may not get the goods of the company, if they sell to those who do not observe the prices indicated or who are on the company's list of undesirables until they are restored to favor by satisfactory assurances of future compliance with the company's schedules of resale prices. Nor is the inference overcome by the con-

clusion stated in the Commission's findings that the merchandising conduct of the company does not constitute a contract or contracts whereby resale prices are fixed, maintained, or enforced. The specific facts found show suppression of the freedom of competition by methods in which the company secures the cooperation of its distributors and customers, which are quite as effectual as agreements express or implied intended to accomplish the same purpose. By these methods the company, although selling its products at prices satisfactory to it, is enabled to prevent competition in their subsequent disposition by preventing all who do not sell at resale prices fixed by it from obtaining its goods.

Under the facts established we have no doubt of the authority and power of the Commission to order a discontinuance of practices in trading, such as are embodied in the system of the Beech-Nut Company.

We are, however, of opinion that the order of the Commission is too broad. The order should have required the company to cease and desist from carrying into effect its so-called Beech-Nut policy by cooperative methods in which the respondent and its distributors, customers and agents undertake to prevent others from obtaining the company's products at less than the prices designated by it—(1) by the practice of reporting the names of dealers who do not observe such resale prices; (2) by causing dealers to be enrolled upon lists of undesirable purchasers who are not to be supplied with the products of the company unless and until they have given satisfactory assurances of their purpose to maintain such designated prices in the future; (3) by employing salesmen or agents to assist in such plan by reporting dealers who do not observe such resale prices, and giving orders of purchase only to such jobbers and wholesalers as sell at the suggested prices and refusing to give such orders to dealers who sell at less than such prices, or who sell to others who sell at less than such prices; (4) by utilizing numbers and symbols marked upon cases containing their products with a view to ascertaining the names of dealers who sell the company's products at less than the suggested prices, or who sell to others who sell at less than such prices in order to prevent such dealers from obtaining the products of the company; or (5) by utilizing any other equivalent cooperative means of accomplishing the maintenance of prices fixed by the company.

The judgment of the Circuit Court of Appeals is reversed, and the case remanded to that court, with instructions to enter judgment in conformity with this opinion.

Reversed.

Mr. Justice Holmes dissenting:

There are obvious limits of propriety to the persistent expression of opinions that do not command the agreement of the Court. But as this case presents a somewhat new field—the determination of what is unfair competition within the meaning of the Federal Trade Commission Act—I venture a few words to explain my dissent. I will not recur

to fundamental questions. The ground on which the respondent is held guilty is that its conduct has a dangerous tendency, unduly to hinder competition or to create monopoly. It is enough to say that this I cannot understand. So far as the Sherman Act is concerned, I had supposed that its policy was aimed against attempts to create a monopoly in the doers of the condemned act or to hinder competition with them. Of course there can be nothing of that sort here. The respondent already has the monopoly of its own goods with the full assent of the law and no one can compete with it with regard to those goods, which are the only ones concerned. It seems obvious that the respondent is not creating a monopoly in them for any one else, although I see nothing to hinder its doing so by conveying them all to one single vendee. The worst that can be said, so far as I see, is that it hinders competition among those who purchase from it. But it seems to me that the very foundation of the policy of the law to keep competition open is that the subject-matter of the competition would be open to all but for the hindrance complained of. I cannot see what that policy has to do with a subject-matter that comes from a single hand that is admitted to be free to shut as closely as it will. And to come back to the words of the statute I cannot see how it is unfair competition to say to those to whom the respondent sells and to the world, you can have my goods only on the terms that I propose, when the existence of any competition in dealing with them depends upon the respondent's will. I see no wrong in so doing, and if I did I should not think it a wrong within the possible scope of the word unfair. Many unfair devices have been exposed in suits under the Sherman Act, but to whom the respondent's conduct is unfair I do not understand.

Mr. Justice McKenna and Mr. Justice Brandeis concur in this opinion.

Mr. Justice McReynolds dissenting:

With regret, I dissent from the opinion and judgment of the Court. This matter was submitted to the Commission upon an agreed statement of facts, the twelfth clause of which—the last but one—declares:

> 12. That the merchandising conduct of respondent heretofore defined and as herein involved does not constitute a contract or contracts whereby resale prices are fixed, maintained and enforced.

Of course, the Packing Company entered into this stipulation relying upon the quoted clause, and I am not at liberty either to disregard it or to minimize the plain import of its words. It is not a mere conclusion of the Commission but a definite and essential admission of record upon which the company rested and without which I must conclude a different case might have been presented.

There is no question of monopoly. Acting alone, respondent certainly had the clear right freely to select its customers—to refuse to deal when

and as it saw fit—and to announce that future sales would be limited to those whose conduct met with its approval.[4]

If the solemn stipulation did not expressly negative the existence of contracts amongst the parties to maintain prices, I should think the detailed facts sufficient to support a finding that there were such agreements. But starting with that plain negation I can find no adequate ground for condemning the respondent.

The very order which the court below is now directed to enter conflicts with the stipulation between the parties by presupposing "methods of cooperation between respondent and the distributors of its products, especially the cooperative methods by which the respondent and the distributors of its products undertake to prevent others from obtaining such products at less than the prices fixed by respondent [by] the cooperation of customers in reporting the names of dealers who do not observe such resale prices with the view to prevent their obtaining the products of the Beech-Nut Company thereafter." How can there be methods of cooperation, cooperative methods, an undertaking to prevent others, or the cooperation of customers with a view to prevent others, when the existence of the essential contracts is definitely excluded?

Having the undoubted right to sell to whom it will why should respondent be enjoined from writing down the names of dealers regarded as undesirable customers? Nor does there appear to be any wrong in maintaining special salesmen who turn over orders to selected wholesalers and who honestly investigate and report to their principal the treatment accorded its products by dealers. Finally, as respondent may freely select customers, how can injury result from marks on packages which enable it to trace their movements? The privilege to sell or not to sell at will surely involves the right by open and honest means to ascertain what selected customers do with goods voluntarily sold to them.

Under the circumstances disclosed, constraint upon the freedom of merchants can only result from withholding trade relations or threatening so to do. These, when acting alone, respondent may assume or decline at pleasure, there being neither monopoly nor attempt to monopolize. And the exercise of this right does not become an unfair method of competition merely because some dealers cannot obtain goods which they desire, and others may be deterred from selling at reduced prices. If a manufacturer should limit his customers to consumers he would thereby destroy competition among dealers, but neither they nor the public could complain.

COMMENTARY: The gist of the majority decision of the court in this case was that the company violated the Federal Trade Commission

[4] *United States* v. *Colgate & Company,* 250 U. S. 300, 39 Sup. Ct. 465, 63 L. Ed. 992, 7 A. L. R. 443; *United States* v. *Schrader's Son, Inc.,* 252 U. S. 85, 40 Sup. Ct. 251, 64 L. Ed. 471; *Frey & Son* v. *Cudahy Packing Company* (decided April 18, 1921) 256 U. S. 208, 41 Sup. Ct. 451, 65 L. Ed. 892.

Act: by placing identifying marks on packages of merchandise which were utilized by the company in tracing the sources of purchase of merchandise offered for sale at cut prices; by securing information as to the identity of price-cutters by means of reports from wholesalers, retailers, and the company's own salesmen; by maintaining a record of price-cutters to whom merchandise was not to be sold or resold; and by inducing wholesalers to refuse to sell to price-cutters.

The statement that the Circuit Court of Appeals erred in its interpretation of the Supreme Court's earlier decision in the Colgate case[5] again emphasized the fact that the Colgate decision was based on a technical legal consideration rather than on the merits of the business practices involved. The decision in this Beech-Nut case, however, was positive and far-reaching in its effects. It is to be noted, moreover, that the question in this case was one of unfair trading under the Federal Trade Commission Act, not a question of monopoly under the Sherman Act as in the Colgate case.

In this Beech-Nut case the dissenting opinion written by Mr. Justice Holmes and concurred in by Mr. Justice McKenna and Mr. Justice Brandeis is more logical to a layman than the majority decision. Statements by Mr. Justice McReynolds, in his dissenting opinion, also were not answered convincingly in the majority decision. These statements were as follows:

> Having the undoubted right to sell to whom it will why should respondent be enjoined from writing down the names of dealers regarded as undesirable customers? Nor does there appear to be any wrong in maintaining special salesmen who turn over orders to selected wholesalers and who honestly investigate and report to their principal the treatment accorded its products by dealers. Finally, as respondent may freely select customers, how can injury result from marks on packages which enable it to trace their movements? The privilege to sell or not to sell at will surely involves the right by open and honest means to ascertain what selected customers do with goods voluntarily sold to them.
>
> Under the circumstances disclosed, constraint upon the freedom of merchants can only result from withholding trade relations or threatening so to do. These, when acting alone, respondent may assume or decline at pleasure, there being neither monopoly nor attempt to monopolize. And the exercise of this right does not become an unfair method of competition merely because some dealers cannot obtain goods which they desire, and others may be deterred from selling at reduced prices. If a manufacturer should limit his customers to consumers he would thereby destroy competition among dealers, but neither they nor the public could complain.

These statements by Mr. Justice McReynolds are to the point. With them and with their import I am in agreement.

---

[5] United States *v.* Colgate & Company, page 473.

The decision by the majority of the court in this case, unintentionally of course, was discriminatory in tendency and subversive of sound ethics. In a statement quoted by the court from its decision in the Colgate case, reference was made with approval to "a manufacturer's undoubted right to specify resale prices and to refuse to deal with any one who failed to maintain the same." According to this statement a manufacturer who sold his products directly to retailers could attempt to secure maintenance of the retail prices which he specified. The Beech-Nut Packing Company, however, was placed in a different position by the fact that it utilized the services of wholesalers in distributing its products, presumably because that method of marketing was more economical than the maintenance of a wholesale sales organization by the company would have been and also because it aided the company in competing effectively with the manufacturers of similar merchandise; it helped the company to maintain intensive distribution.

Inasmuch as a company which sells its products directly to retailers was stated to have the right to specify resale prices to consumers and to refuse to sell to a price-cutter, one effect of this decision will be to discourage distribution through wholesalers, even when that method is the most economical for the manufacturer. For if a manufacturer like the Beech-Nut Packing Company, which distributes its products through wholesalers, may not enlist the cooperation of the wholesalers in securing the observance of resale prices by retailers while a manufacturing company selling directly to retailers is privileged to secure observance of his suggested resale prices by retailers by the exercise of the right to refuse to sell to price-cutters, the effect is to discriminate against the employment of wholesalers and to encourage the use of less economical methods of distribution by manufacturers who conclude that they can develop their business and meet competition most effectively by the standardization of resale prices to consumers.

As a practical matter, when a company which is honorable in its dealings suggests standard resale prices to consumers, it will seek to have them observed. If it is to have them observed, it must take cognizance of price-cutting and price-cutters. It must expect to receive information regarding price-cutting and attempt to dissuade price-cutters from continuing the practice. For operating purposes, it is essential that the company keep a record of its negotiations and transactions with price-cutters and a list of the firms with which it has decided not to deal. If the company distributes its products through wholesalers, it should be privileged to enlist their cooperation in discouraging price-cutting by retailers, in order that that method of distribution be accorded fair treatment.

In this case the majority opinion of the court dealt superficially with

the question, probably because of a failure fully to comprehend the situation. The court stated that a manufacturer had the undoubted right to specify resale prices. If the Beech-Nut Packing Company was within its rights in specifying standard resale prices to consumers, its action in specifying the resale prices involved a moral obligation to seek to have those prices observed; any other course would have been one of hypocrisy. The methods which the company employed for carrying out its policy honorably, therefore, should not have been condemned. Since the court recognized a manufacturer's right to specify resale prices, but prohibited the use of effective means of exercising that right, its decision in this case was not conducive to the observance of high standards of ethics in business.

June, 1926 M. T. C.

Federal Trade Commission *v.* Cream of Wheat Company[1]

MANUFACTURER—CEREAL

Price Maintenance—*Standardization of Resale Prices by Cooperative Means Held Illegal.* The company, which manufactured and sold to wholesalers and large retailers a nationally advertised cereal, endeavored to maintain standard resale prices for its product. The Federal Trade Commission ordered the company to discontinue its policy of maintaining minimum resale prices by cooperative means such as: entering into contracts or understandings with customers; securing reports as to price-cutting; notifying customers and sales agents of price-cutters to whom sales were not to be made; requiring extra price from price-cutters during a probation period as condition of their reinstatement on the regular basis.[2]

Price Maintenance—*Variance of Prices to Penalize Price-Cutters.* The company, which manufactured and sold a nationally advertised cereal, endeavored to maintain standard resale prices for its product. As a means to this end, the company placed price-cutters upon probation, penalizing them as to prices charged them for its product until it appeared that they would not cut prices again. This practice was declared illegal by the Federal Trade Commission.[2]

(1925)

COMPLAINT

Acting in the public interest pursuant to the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes," the Federal Trade Commission charges that Cream of Wheat Company, hereinafter referred to as respondent, has been and is using unfair methods of competition in commerce in violation of the provisions of Section 5 of said Act.

. . . .

Paragraph 3. The acts of respondent alleged in the two last preceding paragraphs, tend to constrain all jobbers, wholesalers, and retailers handling its product to sell the same uniformly at the prices fixed by respondent to retailers and to the public and to prevent them from selling such products and merchandise at such lower prices as they deemed would be adequate and warranted, and are adequate and warranted, by their respective selling costs and efficiency and thus tend to hinder and suppress competition in the sales of such products by jobbers,

[1] Federal Trade Commission, Docket 890, April 11, 1925.

[2] Headnote by Graduate School of Business Administration.

wholesalers, and retailers; respondent's said practices, therefore, tended and still tend unduly to restrain the natural flow of commerce and the freedom of competition in the channels of interstate trade.

. . . .

FINDINGS AS TO THE FACTS

Paragraph 1. A stipulation as to the facts, in lieu of testimony (Commission's Exhibit 1)[3] was entered into by counsel for the Commission and for the respondent, providing for offering by either party of testimony or other evidence of facts in addition to that therein stipulated, and testimony or evidence supplementing or explaining the same subject-matter. Such additional, supplementary, and explanatory evidence was given in the form of testimony and exhibits chiefly, which make up the bulk of the record in this case. The following findings are based on all the evidence named.

Par. 2. The respondent, Cream of Wheat Company, since 1897 and during all the times herein mentioned, has been, and still is, a corporation duly organized and existing under the laws of the state of North Dakota and a citizen of that state, and is, and has been for over twenty years last past, duly licensed and qualified in accordance with the laws of the state of Minnesota, to transact business in the state of Minnesota, and during the past twenty years has had, and still has, its principal place of business in the city of Minneapolis, Minnesota.

Par. 3. The respondent, during all the times herein mentioned, has been, and still is, engaged exclusively in the business of packing and selling and distributing to its customers throughout the United States and in foreign countries, under the name of "Cream of Wheat," purified middlings, which said packing and selling is all done at and from the plant of respondent located in Minneapolis (except a plant at Winnipeg, which supplies the Canadian trade). Respondent and its distributors generally are engaged in interstate commerce in the sale of Cream of Wheat among the states of the United States and between the United States and foreign countries. Shipments to purchasers are made either directly from respondent's plant in Minneapolis, or from warehouses situated at other places in the United States, in which warehouses quantities of Cream of Wheat are kept by respondent, and from which warehouses shipments to purchasers are made under its direction.

Such warehouses are either private or public warehouses receiving shipments from respondent and storing the same, and making shipments therefrom on the order of respondent and at the usual warehouse charges for such purposes, which said charges are paid by respondent. Such warehouses so used by respondent are located in about 40 cities scattered throughout the United States.

Par. 4. Respondent employs no traveling salesmen. Respondent has at certain localities in the United States, soliciting sales agents, through whom it receives orders for Cream of Wheat, which orders are

[3] Exhibits not published herein.

taken subject to acceptance by respondent and if accepted, are filled by respondent, or under its direction, either from its stock of Cream of Wheat in Minneapolis, or from the stock in one of its warehouses. Such agents, at the time of this stipulation and for varying periods prior thereto, are:

Lamont, Corliss & Company, 131 Hudson St., New York City.
C. G. Whitcomb, 20 E. Lake St., Chicago, Illinois.
Spohn & Thamer, Denver, Colorado.
Spohn & Clark, Salt Lake City, Utah.
Cooney Brokerage Company, Billings, Montana.
The Johnson Leiber Company, Boise, Idaho.
Hodgson Brothers Commission Company, Spokane, Washington.
Ariss, Campbell & Gault, Seattle, Washington.
Ariss, Campbell & Gault, Tacoma, Washington.
Ariss, Campbell & Gault, Portland, Oregon.
C. E. Cumberson Company, 25 Spear St., San Francisco, California.
Bradley, Kuhl & Company, 849 Traction Ave., Los Angeles, California.
L. H. Kassel & Company, Fort Worth, Texas.

With the exception of C. G. Whitcomb, none of said sales agents are engaged exclusively in the sale of Cream of Wheat. Lamont, Corliss & Company are sales agents for the marketers of 10 different lines, in some of which their business exceeds that done by them in Cream of Wheat.

Par. 5. The sales and distributing of Cream of Wheat by respondent in its business as above described, extend to all the states of the United States, and all territory within its jurisdiction, and, to some extent, to foreign countries. Respondent has sold, and now sells, principally to wholesalers or jobbers. The number of customers to whom it sells is approximately 4,500, which include nearly the entire number of wholesalers of cereal products and groceries in the United States. Cream of Wheat is sold at retail, that is, to the ultimate consumer, by nearly all retailers of groceries and cereal products in the United States, estimated by respondent to number over 300,000. The wholesalers or jobbers to whom respondent sells, resell, in turn, to retailers within the radius of their respective trades. Sales and deliveries are made by respondent at a uniform delivered price to such purchasers, f.o.b. cars at the place of purchaser's business.

Par. 6. Respondent has sold, and now sells, direct to certain large retailers whose business enables them to buy in wholesale or carload lots, at the prices and upon the terms required by respondent from wholesalers. Among such retailers are certain so-called "chain store organizations." A "chain store organization," as here intended, is an individual, corporation or partnership owning or operating a group of retail stores.

Par. 7. Respondent refuses to sell to "collective purchasers," or buying pools of independent stores, as distinguished from "chain stores." Respondent refuses to sell to any customer who buys for the purpose of reselling to other customers of the same class, for instance, wholesalers, and respondent refuses to sell to a purchaser in carload lots and at carload prices, who buys for the purpose of dividing such shipments with other customers, or for the purpose of having "drop" shipments—that is, a part of a carload delivered at one point and another part of the same carload at another point. Respondent does not sell to mail-order houses. These practices described in this paragraph have been in force for the past 20 years.

Par. 8. Respondent markets Cream of Wheat in unit packages of 28 ounces net per package, which are packed in wooden boxes, or cases, 36 packages to the case; and in making sales, respondent sells in either carload lots or less, delivered f.o.b. cars at customer's city, terms 30 days net or 1% discount for cash, 10 days from date of invoice.

The average annual sales by respondent in the United States during the past 10 years have been about 600,000 cases. In the year 1921 they were approximately 675,000 cases. The gross sales receipts by respondent for the 10 years 1912-1921 were as follows: 1912, $2,645,-855; 1913, $2,810,560; 1914, $2,897,424; 1915, $2,982,776; 1916, $3,171,027; 1917, $2,871,845; 1918, $2,725,710; 1919, $4,964,142; 1920, $5,354,494; 1921, $5,785,918.

Par. 9. The unit packages of 28 ounces each, in which respondent sells its product, consist, besides the contents of Cream of Wheat, of paper-box containers or cartons, on each of which is the name "Cream of Wheat," together with the copyrighted illustration used by respondent in connection with its business, and the name of respondent and its place of business, namely, Minneapolis, Minnesota. The name "Cream of Wheat" is the peculiar and sole trade name used by respondent in its said business, and respondent has acquired and is the sole owner of the trade-mark of the said name "Cream of Wheat," and of the copyright covering the printed illustration shown on such carton in which said Cream of Wheat is packed, and respondent has used the said name and carton in its said business for more than 20 years last past. The wooden boxes or cases in which said unit packages are sold are marked under the trade name of "Cream of Wheat."

Par. 10. "Purified middlings" are the granules of wheat produced at different stages in the process of crushing the wheat berry in the manufacture of flour, separated by screening and wind from impurities and innutritious parts. About 74% of the wheat made into flour passes through the stage of purified middlings. If more than 6% of such purified middlings is drawn off, the quality of the flour is deteriorated. Of the total volume of purified middlings commercially available, a small fraction, approximately 5%, is used by the respondent for its "Cream of Wheat." The purified middlings from hard wheat grown in the Northwest are used for Cream of Wheat and also for competing brands.

Par. 11. Respondent buys in the open market certain quantities of purified middlings of such quality and size and color as accord with the standard of selection fixed by respondent for the uses for which Cream of Wheat is used, and packs and markets the same under its said brand of "Cream of Wheat." Such "middlings" so marketed by respondent is first cleaned by it of dust and extraneous matter by wind and gravity, and in passing through the machinery for such purpose and to deliver the same into the packing cartons, such "middlings" is subjected to heat not exceeding 180 degrees Fahrenheit, by which impurities, in the form of animal life, are diminished or eliminated. After such cleaning, the purified middlings is packed in cartons, which are sealed tightly to prevent or diminish deterioration through atmospheric changes or by the entrance of animal life such as weevils.

Par. 12. Cream of Wheat, as sold by respondent, has acquired with the public a wide and favorable reputation, and the consumption has steadily increased in this country and foreign countries. It is used, after cooking, by the individual consumer as breakfast food, and in other ways.

Par. 13. Purified middlings, as a cereal food, is sold under the name of "purified middlings" and also, in the United States, in various localities, in package form under various trade-marks or names, in competition with Cream of Wheat in interstate commerce.

Intrinsically, other brands of cereal foods prepared from purified middlings are as wholesome and as valuable as a food as "Cream of Wheat"; in fact, they are essentially the same except as to name.

Par. 14. Respondent has always conducted, on a very large and expensive scale, a system of national advertising of Cream of Wheat in magazines and periodicals of the widest circulation such as the *Ladies' Home Journal* and the *Saturday Evening Post.*

Par. 15. Respondent sells, it is roughly estimated, about 40% of the package cereal foods prepared from purified wheat middlings and sold in the United States by concerns which advertise nationally. Such firms which advertise nationally sell the great bulk of package cereal foods prepared from purified wheat middlings.

Par. 16. Sales and deliveries of Cream of Wheat are made by respondent at a uniform delivered price at any given time, or at a price which makes the cost of Cream of Wheat to all purchasers the same, f.o.b. cars their places of business, no matter at what points within the United States the places of business of such purchasers may be located. From September, 1916, to May, 1919, however, respondent charged higher delivered prices for Cream of Wheat delivered at points in the Pacific Northwest than for that delivered at points east of the Rocky Mountains.

Par. 17. Excluding these exceptional figures for the Pacific Northwest, respondent's prices to wholesalers and the resale prices which it requested them to observe have been as follows:

	In Carload Lots	In Less-than-Carload Lots	Minimum Resale Price Requested
Prior to Sept. 14, 1916	$3.95	$4.10	$4.50
Sept. 14, 1916, to Apr. 15, 1917	4 75	4.90	5.40
Apr. 18, 1917, to May 11, 1919	5.05	5.20	5.75
May 11 to Nov. 22, 1919	6.65	6.80	7.50
Nov. 22, 1919, to Dec. 16, 1921	8.00	8.15	9.00
Dec. 16, 1921, to Dec. 16, 1922	6.65	6.80	7.50
Dec. 16, 1922, to —	6.05	6.20	6.90

Par. 18. When it sells direct to retailers, respondent does so on the same terms as to payment and at the same prices which at the same time apply in its sales to wholesalers.

In the case of retailers to whom respondent sells direct, when the resale price per case (wholesale) was $4.50, the minimum resale price per package was 14 cents.

When the resale price per case (wholesale) was $7.50, the minimum resale price per package was 25 cents.

When the resale price per case (wholesale) was $9, the minimum resale price per package was 30 cents.

Par. 19. The term "resale price" as used in these findings means the resale price named by respondent, and "price-cutting" and "price-cutter" mean respectively selling below and sellers below such resale prices.

Par. 20. Respondent's prices and resale prices were regularly communicated to customers and prospective customers in typewritten or mimeographed form, in connection with inquiries and orders from new customers and upon change of its prices by respondent.

Par. 21. Soon after its organization in 1897, respondent adopted and has since maintained a policy of fixing and enforcing minimum resale prices at which Cream of Wheat should be sold by its vendees, and, among the means adopted by it to that end, it has advised its agents and customers and prospective customers from time to time of its resale prices and requested of its customers and prospective customers that they observe such resale prices in all their sales, declaring its purpose to refuse to accept or fill any further orders from those who should sell at prices below said minimum, or from those who supplied dealers who so cut its resale prices.

Respondent has informed itself as to cutting of its resale prices through advertisements and lists of prices put out by customers, which have come to its attention, and has solicited and been furnished in response with reports or information of cutting of its resale prices by customers, (*a*) from other customers, (*b*) from other dealers or associations of dealers, and (*c*) from respondent's sales agent. Where it learned by such means that customers were cutting its resale prices, or

selling to others who were, it has been its policy to refuse further sales where it deemed such action necessary to prevent further cutting of its resale prices. Respondent, prior to 1913, entered into agreements and contracts with customers, by which, in terms, they bound themselves to maintain its resale prices, and since it has at times sought and received from customers and prospective customers assurances of the observance of its resale prices amounting in substance to agreements or understandings to that end.

Par. 22. Under date of January 25, 1913, respondent issued to the trade a letter, stating its purpose to be "to obviate any misunderstanding" as to its position "with regard to the question of maintenance of prices on our product" and to place before all its customers "a statement of our position which shall control as to all future dealings." It proceeds to "notify all our customers" that it hereby withdraws and rescinds all orders, rules, directions, and requests, and (while denying the existence of any agreement, express or implied) "we also withdraw and rescind, in so far as any such exist, all agreements, express or implied, actual or constructive, now or heretofore existing between this company and its customers with reference to the maintenance of prices by such customers," and that sales of Cream of Wheat shall not be affected by previous communications on that subject. It states that in the future, the respondent shall not sell to consumers, to retailers, or to chain or department stores, but exclusively to wholesalers; that it shall not require of them any agreement to "maintain any price which we may establish or observe any rules which we may see fit to make. We do, however, request that they shall maintain, in their sales to their retail customers, such prices as we deem to be to the best interests of the consumer and to our own business and to the general trade," and that they would observe such rules as to sales as respondent may announce. Respondent warns that by this it does not intend to waive its right to refuse sales to any customer who fails to comply with any rule or request made by it, whose infringement it deems prejudicial to the interests named above, and that it will exercise such right so far as it may lawfully. It disclaims any purpose to create any restraint of trade or monopoly, but to protect the consumer from them from others.

It states that "in the case of a perishable product like Cream of Wheat, it is essential to the protection of the consumer" and its business that it be kept moving through the greatest possible number of dealers, to conserve the reliance of the consumer on its purity and freshness. It therefore "prohibits, so far as we may, practices which prevent" such distribution. "The prices fixed by us" are fair, it declares to consumer and dealers. "A wholesaler who buys in abnormally large quantities and cuts the price," it declares, creates unfair competition and acquires a monopoly, defeats proper distribution and causes stale goods to be offered for sale. "The only way," the letter concludes, to protect the value of its product and business to itself and the trade, "is by discouraging, through the announcement and enforcement of proper rules

and requests, all practices by dealers which are repugnant to the object which we seek to attain."

Par. 23. Respondent's general admissions of its practices relating to resale prices . . . . are divided into two statements, paragraphs 17 and 19, purporting to cover its practices prior to and since January, 1913, the date of the letter, abstract of which appears in paragraph 22 hereof, as a dividing line. The stipulation contains the provision in paragraph 17 thereof: "Nothing contained in this paragraph 17 shall be deemed an admission by the Commission that the policy and practices as therein stated as existing prior to January, 1913, have not continued thereafter." Paragraph 17 of the stipulation includes the following: "Respondent also, prior to 1913, entered into agreements and contracts with customers, by which, in terms, they bound themselves to maintain its resale price." Paragraph 19 of the stipulation, being respondent's admissions as to its resale price practices subsequent to January, 1913, does not include agreements. It substantially repeats the other practices set out in paragraph 17. As these practices continued after January, 1913, so, the evidence shows, respondent did not abandon altogether agreements in substance with its customers to observe its resale prices, though it modified them in form. It employed such means of enforcing its resale prices, from time to time, as are more particularly set forth in the following findings.

Par. 24. Early in 1921 the National Chain Store Grocers' Association opened negotiations with the Cream of Wheat Company looking to sales of Cream of Wheat direct to its members, conducting retail stores. Paragraph 20 of the stipulation . . . . covers the history of these negotiations, including correspondence. The letter of respondent's president to the association's secretary, dated February 28, 1921, in reviewing respondent's past dealings particularly with chain stores, contains references to "personal" agreements, "explicit understanding," "express understanding," "promises," by customers, past and existing, subsequent to 1913, to observe respondent's resale prices, on the keeping of which continuance of sales to them by respondent depends. In the letter of February 25, 1921, President Mapes makes the respondent's policy as outlined by him apply to wholesalers as well: "In other words, we have continued to sell the American Stores Company and the National Grocery Company because they have kept their promises with regard to the resale price. We have refused to sell the Great Atlantic and Pacific Tea Company because they did not keep their promises. The same thing applies to wholesale grocers who are in no way connected with the retail trade, either directly or indirectly. We have not sold Reid-Murdock & Company, of Chicago, a case of goods for five or six years, for the reason that they refused to comply with our wishes with regard to resale prices to their retail customers, and we are frequently obliged to refuse sales to exclusive wholesalers for the same reason." Respondent's president states, in the same letter, "There is no reason, as far as the writer can see, why we might not be willing to

sell concerns such as, for example, are represented by the officers whom you show on your letter-head, if we could be assured that, notwithstanding the fact that on account of their buying in carload quantities, they were not taking advantage of this to resell in their retail stores at a price lower than the ordinary retailer not connected with any chain store proposition, can afford to sell. Unfortunately, however, as was evidenced particularly in the case of the Great Atlantic and Pacific Tea Company, we cannot always trust to their promises. They are by no manner of means the only sinners in this respect."

In his letter of March 26, 1921, President Mapes states that the only reason he saw why respondent might not sell to the chain stores was "the question as to whether or not we could depend on these chain stores to maintain what we would consider an adequate retail price on our goods, which at present we would say would be 30 cents a package." Distinguishing between chain stores constituting "an organization owned and controlled by one company" having a large number of retail stores "absolutely under their control," and loose associations of retail stores to enable its members to buy at wholesale prices, President Mapes states: "The second class, I cannot see that it would be desirable for us to sell under any circumstances. The first class, such as you represent, we might be willing to place on our list of customers, always providing that we could be satisfied that they would absolutely maintain our resale retail price, in all of their stores. The difficulty, however, with this would lie in the fact as to whether or no the National Chain Store Grocers' Association could control their members. As you say, we are selling some of your members, and this is for the reason that, in as far as we know, they live up to their agreements. We do not sell, for example, the Great Atlantic and Pacific Tea Company, because they did not live up to their agreements, and we have no reason to suppose that their word is worth anything more now than it was several years ago." He then states: "Should we sell to members of your association, it would have to be on identically the same basis as we now sell to the wholesale grocery trade—namely, we do not exact any contract or make any agreements of any kind or nature whatsoever, with the wholesale grocer to whom we sell our goods, and after buying any quantity of our goods we do not question his right to resell it at any price which he may see fit. We do, however, suggest that, in the general interest of the trade, we consider it advisable that he should maintain a resale price," and so forth, stating terms of sale, and so forth. He then states the policy of the company to refuse further sales to dealers who cut respondent's resale prices, also to advise other customers of such refusal and cut off any customer who thereafter sells to such resale price-cutters.

The correspondence in evidence between the respondent and the National Chain Store Grocers' Association and members of that association, looking to direct selling to the latter, read in the light of these opening letters of the series, show that respondent was operating in some cases on the basis of agreements to maintain resale prices,

and that respondent's letters look to and result in agreements or understandings with its prospective customers for the maintenance of its resale prices, notwithstanding the express disclaimers in them of contracts or agreements; particularly in view of their repeated statements of the condition of sales, as, for example, "always providing that we could be satisfied that they would absolutely maintain our resale retail price, in all their stores" (letter of March 26, 1921); "provided we can be satisfied that your company, including all of your branch stores, without exception, can see its way clear to comply with our request as to the price at which you will resell Cream of Wheat," and so forth (letter of April 22, 1921).

The policy stated in respondent's letters is declared therein to apply to its dealings generally, that is, with wholesalers as well as retailers: "Bear in mind I am outlining no different method of procedure with any member of your association, than we follow with all of the customers which we now have on our books, which run into a great many thousands." (Letter of March 26, 1921).

In accepting business with the National Association's members, respondent relied on their control of their unit stores in the matter of maintaining its resale prices, and their implied assurance that such control would be exercised to secure such observance. If respondent did not look to an agreement or understanding to that end, it could have merely exercised its right to cut off individual members of the chain organization which cut its resale prices. The letters of respondent to individual chain store organizations, repeating its statement to the National Association of the condition as given above, of its doing business, look to assurance in advance, or agreement, for the observance of its resale prices. The responses of individual chain store organizations, in accepting the offer of sales with the conditions as to observance of respondent's resale prices named in respondent's letters to them, show they understood them as calling for an agreement and that they responded on that basis. Respondent acted on such responses. Besides the cases referred to in paragraph 20 of the stipulation . . . . the correspondence with Larkin & Company . . . . and with James Butler, Inc., ... are instances of respondent's dealings with chain stores as to agreements or understandings, down to the time of the complaint herein, and later.

Illustrating more fully the character of the transactions between respondent and members of the National Chain Store Grocers' Association, following the negotiations between respondent and that organization described above and fully set out in paragraph 20 of the stipulation . . . . respondent on April 22, 1921, addressed a letter to Charles M. Decker & Brothers, Thrift Stores, Inc., Orange, New Jersey, acknowledging their letter requesting that company be again put on respondent's list of customers, and stating its terms as follows:

> We will be very glad to add your company to our list of customers to whom we sell Cream of Wheat direct, provided we can

be satisfied that your company, including all of your branch stores, without exception, can see your way clear to comply with our request as to the price at which you will resell Cream of Wheat, as well as in certain other respects which we will enumerate further on in this letter.

As you know, in selling our product to our wholesale customers, we do not in any way make any agreement with them or attempt to make any agreement with them, as to the price at which they shall resell Cream of Wheat to their retail trade. In selling them, however, we request that in reselling Cream of Wheat to their retail trade they do so at a price not less than the price we request of them.

In the event a wholesale customer does not see fit to comply with our request as to the price at which he shall resell Cream of Wheat to his retail trade, we exercise the right which we legally have, and refuse to sell him any further quantity of our product.

In the case of your company, selling direct as it does, to the consumer, were we to put you on our list of customers for the direct sale of Cream of Wheat, it would be with the request that you resell to your consumer trade at a price which at present would be not less than 30 cents per package.

This would apply, without exception, to each and every one of your branch stores. If any of these branch stores, for any reason whatever, sold Cream of Wheat for less than our requested price, we would certainly refuse to sell that branch, and all the other stores of your company, any further quantity of Cream of Wheat.

And, in the event we did so refuse to sell your company Cream of Wheat, we would undoubtedly so advise all the other companies in your association, as well as the wholesalers in your territory. And in advising them of our refusal to sell you, we would request them not to resell Cream of Wheat to you.

In the event they did sell you Cream of Wheat, contrary to our request, we would refuse to sell them further quantities of our product.

As stated above, if we can satisfy ourselves that our requests as stated above will be complied with, we will be very glad to sell Cream of Wheat to you direct. We are willing to do this in the case of companies such as yours because, through stock ownership of your branches, you can absolutely control the selling policy of those branches if you wish.

In the event we sell you Cream of Wheat direct, our price to you, at present, would be $8 per case in car lots (minimum car 500 cases), or $8.15 per case in less than car lots; terms 30 days net or 10% discount if invoice is paid within 10 days of date of invoice.

The above car-lot price is the price delivered f.o.b. cars any regularly established commercial freight delivery station, where

car-lot shipments are regularly received. The less-than-car-lot price is the price delivered f.o.b. warehouse door in any town or city where we have warehouse stocks, or f.o.b. any regularly established commercial freight delivery station in a town or city in which your company has a branch store—and in not less than five-case lots.

Under no circumstances do we make drop shipments of our product.

In selling you Cream of Wheat it would be on the understanding that your purchases were for the sole use and sale from your own branch stores, and not to be resold or divided with your competitors, under any conditions.

We have gone into this matter at length, as, in the event we make a connection with your company, we want you to be thoroughly familiar with our selling policy. This policy we have maintained for a good many years, and is one we intend to maintain so far as we legally can in the years to come.

We thank you for your letter regarding this matter and shall await with interest your further favors.

Yours very truly,

Cream of Wheat

By D. F. Bull (Signed)

Treasurer

This letter was repeated in identical terms on September 21, 1921.

Letters practically identical in terms with the above letter of April 22, 1921, were addressed by the respondent, in response to applications by members of the National Chain Store Grocers' Association for direct sales to them of Cream of Wheat, to:

Kroger Grocery and Baking Company, Cincinnati, Ohio; Pender-Dilworth, Inc., Norfolk, Virginia; Sanitary Grocery Company, Inc., Washington, D. C.; The Fisher Brothers, Cleveland, Ohio; H. C. Bohack Company, Inc., Brooklyn, New York; and others, representing together several thousand retail stores.

In its letter to the Pender-Dilworth Company, Inc., of Norfolk, Virginia, under date of January 12, 1922, stating its terms as set out in full in the letter to Decker Brothers above, the respondent added: "We are not shipping the order for 100 cases until we hear from you, as we wish to be satisfied that your ideas with regard to the resale of our products at retail agree with our views before we place you on our list of customers for the direct sale of Cream of Wheat." The Pender-Dilworth Company telegraphed to respondent under date of January 12, 1922: "Ship immediately 100 cases stop Will comply with all conditions stop Yours 12 instant."

In reply to the letter of respondent of the form above indicated addressed to it under date of August 11, 1921, the Sanitary Grocery Company, of Washington, D. C., replied under date of August 15, 1921:

> Note all that you have said. Have read your letter carefully. We simply "saw wood" and do business as we have done in the past.

The respondent, replying under date of August 26, 1921, writes:

> We thank you for your letter of the 15th and are glad to note that your ideas coincide with ours with regard to the sale of Cream of Wheat, as indicated in our letter of August 11.

Respondent, under date of August 29, 1921, wrote to its sales agents, Lamont, Corliss & Company, as follows, referring to the Sanitary Grocery Company:

> Their reply has been received and they agree to conform to our wishes. You may, therefore, accept their orders with the terms as stated in our letter of August 11, and we trust you will be good enough to have your representative watch these people to see that they maintain a sale price in their retail stores at 30 cents per package.

In response to a letter similar to that of April 22, 1921, quoted above, and concluding: "We thank you for your order and shall await with interest your further favors," Albrecht & Company, of Akron, Ohio, replied under date of May 24, 1922: "If your price is reduced or advanced at any time in the future, if you will advise us your minimum price we will be glad to conform to it."

Respondent replied to this letter on May 31, 1922:

> Please understand that we do not want any agreement with you, or anything like an agreement, as to how you shall resell our product. We simply reserve the right to refuse to sell you any more of our product in the event you did not see fit to comply with any request which we make of you, in connection with the sale of our product. . . . . If you still wish us to send you 25 cases of Cream of Wheat, kindly wire us at our expense, and we will immediately forward your order.

Under date of October 5, 1921, the H. C. Bohack Company, Inc., of Brooklyn, New York, a member of the National Chain Store Grocers' Association, applied to the respondent to be put on its list of customers whom it sold direct, and the respondent requested its sales agents, Lamont, Corliss & Company, under date of October 11, 1921, to give it a report on the applicant, which was done, and resulted in the respondent's addressing a letter setting out its terms as quoted above, in somewhat abbreviated form. On November 1, 1921, the Bohack Company replied: "We are in receipt of your letter of October 26th, and we agree to live up to your requirements regarding the sale of Cream of Wheat," adding shipping directions. On November 7, 1921, the respondent wrote the Bohack Company, disclaiming agreements as to resale prices, and stating that Bohack Company's order of 500 cases of Cream of Wheat would be promptly filled.

In response to the circular letter (April 22, 1921, quoted above), the Larkin Company, of Buffalo, New York, wrote under date of September 15, 1921:

> We have your favor of September 10 referring to our order No. 102,805 for 25 cases of Cream of Wheat. We wish to assure you that we will abide by any suggestion from you as to the retailing of Cream of Wheat and we are quite sure you will not have any trouble on any price-cutting from us.

On September 21, 1921, respondent sent its agents, Lamont, Corliss & Company, a copy of Larkin Company's letter of September 15, asking its agents to see that its order was filled. And respondent on the same date wrote the Larkin Company that "We will be very glad to receive any orders for Cream of Wheat with which you may see fit to favor us." . . . .

In response to application for direct sales of Cream of Wheat, respondent wrote James Butler, Inc., on February 20, 1922, a letter similar to those cited above, stating its terms for selling to chain stores and concluding: "We thank you for your letter regarding this matter, and shall await with interest your further favors."

On February 24, 1922, James Butler, Inc., wrote: "We are in receipt of your favor of the 20th inst., and contents carefully noted. We are fully in accord with your suggestion that the retail selling price of this product be maintained, which at present is 25 cents per package to the consumer and which we agree to carry out in all our branch stores."

On February 27, 1922, respondent wrote Butler, Inc., disclaiming any agreement as to resale prices and thanking Butler, Inc., for its order and indicating prompt shipment. . . . .

The foregoing propositions as to agreements are sustained by the evidence of this correspondence . . . . as a whole, notwithstanding the disclaimer of any agreement contained in the letters by respondent.

Par. 25. The consideration referred to in respondent's letters, that members of chain stores "cannot resist the temptation to cut the resale price below a figure which the retailer not connected with a chain store but buying at the retail price directly from the wholesaler, can afford to sell it," emphasizes the need which respondent felt of being assured in advance that the chain stores would not cut its resale prices, and the importance to it of securing some binding agreement or assurance in order to keep them in line. That those resale prices requested of retailers involved an inordinate profit to chain stores which paid no wholesalers' profits, emphasizes also the suppression of competition involved by respondent's making their observance a condition of doing business with these chain stores.

Par. 26. In its correspondence with customers, or with prospective customers, on the subject of resale prices, respondent generally has accompanied its statement of its policy and practices in relation thereto,

as elsewhere set forth in these findings, with declarations in various forms to the effect that it did not make or wish any agreement that the customer addressed would maintain its resale prices, or anything resembling such an agreement.

The disclaimers by respondent in this correspondence or elsewhere of seeking or entering into agreements for the maintenance of its resale prices, must be judged in the light of the foregoing and other evidence of agreements hereafter cited. The correspondence referred to was addressed by respondent to prospective customers and its terms, as reasonably understood, must be taken to be the basis of their response and action and so intended by respondent. Court decisions had advised respondent that such agreements were unlawful, and disavowal of them and avoidance of formal agreements was expedient. But the question remains whether in fact such agreements existed, and we find that the evidence cited here and elsewhere in these findings establish that such agreements or understandings between respondent and customers for the maintenance of its resale prices were resorted to by respondent.

Par 27. Respondent's witnesses, Frederick Clifford and Daniel F. Bull, in their testimony, deny the correctness of the statement of the policy and practices of respondent in regard to its resale prices as set out by the letters of President Mapes discussed in the preceding paragraph and included in the stipulation, ... although Bull repeats much of their statements in letters to chain stores signed by him.

Emory Mapes was one of the original organizers and stockholders of respondent, and secretary and co-manager of its business and sales from 1900 to January, 1919, when he became sole general manager, including sales, and president. He conducted the business as general manager and president until his death in October, 1921, prior to the taking of testimony herein.

Frederick Clifford, respondent's witness, was also one of the organizers and original stockholders of respondent and treasurer and co-manager with Mapes of the business and sales department down to the time of Mapes becoming general manager and president in January, 1919, when he ceased to hold any office or have any part in the management. Clifford's separation from the management, according to his testimony, was due to a personal misunderstanding with Mr. Mapes. Clifford subsequently, in June, 1921, became a director, after 2½ years, but held no executive capacity whatever.

Daniel F. Bull became treasurer in February, 1919, and was assistant manager under Mr. Mapes. He became general manager in November, 1921, after the death of Mr. Mapes and continued as such, acting in such capacity at the time of the hearing.

Clifford could not speak from knowledge acquired from any personal participation in the management of respondent's sales or correspondence after January, 1919. Bull had no connection with the company prior to 1919.

Par. 28. In dealing with its customers generally, other than chain stores, in cases where cutting of its resale prices had come to its attention through reports of competing customers or respondent's agents or otherwise, respondent, in taking measures to correct such price-cutting, while generally disclaiming a desire for agreements, so presented its policy as to resale prices that, as a fact, customers responded with assurances of their intention to adhere to its resale prices, and sales have continued or been resumed on that basis. This is illustrated by the following cases:

On March 2, 1921, respondent telegraphed S. S. Pierce Company, of Boston:

> In reply to your wire of even date, will say, our New York agents advise us that you declined to maintain what we consider a fair resale price. We have consequently instructed them to decline your further orders until such time as this matter can be satisfactorily adjusted, if possible. We are writing you today fully.

On March 3, 1921, Lamont, Corliss & Company, of New York, respondent's sales agents in that territory, telegraphed respondent:

> Referring to Mr. Mapes' letter of February 21, Pierce Company have restored price, and Mr. Eaton, their buyer, has satisfied us that they intend to abide by our terms without exception. May we release orders for 50 cases sent you February 26?

On the same date respondent telegraphed Lamont, Corliss & Company:

> Basing our action upon statements contained in your wire March 3, you may sell S. S. Pierce Company until further advised.

On March 2 respondent advised S. S. Pierce Company that Lamont, Corliss & Company's agent had no authority to make any promises for respondent. . . . . Respondent on January 24, 1921, after acknowledging an order for 5 cases of Cream of Wheat from Hi Wo & Company, Benson, Arizona, wrote:

> We should like to make shipment, but we find that on April 22, 1919, we wrote you that you had been complained against by other dealers for cutting prices. On July 26 we wrote you calling your attention to our letter of April 22 and asked for a reply thereto. This was a year and a half ago and we have not heard from you since. Before making shipment of this order to you we should like to have your positive assurance that you will respect our terms, remitting promptly within 30 days from date of invoice, and that you will also respect our request that these goods be sold at a price of not less than $9 per case. Under this assurance we will take the matter up with you further.

Under date of January 29, 1921, Hi Wo & Company wrote respondent:

> We agree to your terms as stated in your letter of January 24, 1921. Please ship us the 5 cases of Cream of Wheat.

On February 8, 1921, respondent acknowledged Hi Wo & Company's letter of January 29, disclaiming any attempt to make an agreement as to resale prices, and stating its request for the observance of the same and its right to refuse to sell if not complied with.

On August 11, 1922, respondent addressed a letter to 13 wholesale grocers of San Antonio, Texas, and 31 wholesale grocers at other Texas points, referring to information it had of price-cutting in those localities, and disclaiming any desire for an agreement for their maintenance, stated:

> Believing, however, it to be to the best interests of all concerned that you do not resell at a price less than that requested of you by us, it is very probable that in the event you did not see fit to comply with any request we made of you we would avail ourselves of the constitutional right which we have of refusing to sell you any further quantity of our product. . . . .

As a result of this communication, respondent entered into an understanding or agreement with wholesalers of San Antonio and other Texas points, that they should sell Cream of Wheat at respondent's suggested resale price. . . . .

In January, 1922, respondent's sales agents in the territory including Los Angeles, California, telegraphed respondent, "San Diego jobbers have broken loose on all cereals and pancake flour, selling them in many instances at absolute jobbers' cost to the retailer," and so forth. Respondent wrote, January 12, in response, thanking its agents for this information and stating that it was "writing each individual San Diego jobber today" and enclosing copy of such letter. This letter, after referring to the information received from its agents as to price-cutting in San Diego, and disclaiming any purpose to secure any agreement as to resale prices and stating its resale prices and its right to refuse to sell for any reason, asked: "Will you, therefore, please write us upon your receipt of this letter and advise us definitely whether you are now, or have been in the past, selling Cream of Wheat to your retail trade at a price less than that required of you by us? We will appreciate a very prompt reply from you to this letter." This resulted in assurances of cooperation from the customers and to one of these, respondent wrote: "Since receiving your letter of February 4, we have made a very careful investigation of this territory. We believe that our customers in this territory will, in the future, see fit to comply with our request to sell Cream of Wheat to their retail trade at a price which at present is not less than $7.50 per case, less 1% discount if invoice is paid within 10 days of date, or 30 days net." . . . .

On May 18, 1922, on the evidence of an invoice received from a competitor of the Feilbach Company of Toledo, Ohio, respondent wrote the latter stating that it had in its hands such evidence of a sale of Cream

of Wheat by it at less than the resale price requested by respondent and that respondent presumed that the customer did not "see fit to comply with our request in this respect;" and concluding "before taking any further action in regard to this matter, we would be very glad to hear from you in regard to this."

On May 29 the Feilbach Company wrote respondent, enclosing information of price-cutting by a competitor and concluding, "We sincerely hope that you will succeed in getting this ruinous competition eliminated. We can assure you that you have our hearty cooperation."

On May 23, respondent, after acknowledging receipt of this information, wrote, "The information we would like to obtain from you is whether you are now, or have been in the past, selling Cream of Wheat for less than its requested resale price."

On May 25, the Feilbach Company wrote respondent, "It is very gratifying to us, that this matter is being adjusted, and you can rest assured that you will have no further complaint from any one in regard to our making any other price than $7.50, as we have given our men positive instructions that this price must be maintained."

In October, 1920, respondent's sales agents in that territory advised it of cutting of its resale prices by John Scowcroft & Sons Company, of Salt Lake City, Utah, and in response (October 19, 1920) respondent authorized its agents to refuse that firm further sales. On October 27, respondent's agents wrote that they had "explained very carefully to Mr. Joseph Scowcroft your policy of protecting the jobbers from price-cutting," and "Mr. Scowcroft advises us that if you will again place them on the jobbers' list that they are under no condition cutting the price, and that in the event of any other jobber cutting, they will report same instead of taking the matter in their own hands."

On November 3, 1920, respondent wrote its agents authorizing them to reinstate the Scowcroft Company, "letting them know that any future deviation from our resale price will result in their being cut off from our list of customers for good," and "with the thorough understanding on their part that they must maintain our desired resale price, in order to remain on our list of customers, you may reinstate them, temporarily, as above." . . . .

Cobb, Bates & Yerxa Company, of Boston, Massachusetts, wholesale grocers, were reinstated May 1, 1922, upon respondent's list of customers of Cream of Wheat after having been cut off for refusing to observe respondent's resale prices upon that product. At the time of reinstatement, it was understood between respondent and Cobb, Bates & Yerxa that the latter should observe the former's resale prices upon Cream of Wheat, and sales were made by respondent to Cobb, Bates & Yerxa on that condition. . . . .

In August, 1919, as a condition of respondent's selling its product to the Amsterdam Grocery Company, of New York, respondent entered into an understanding providing for the maintenance by such grocery company, its vendee, of respondent's suggested resale prices of Cream of Wheat. . . . .

Par. 29. Respondent's agents have been fully advised by respondent of its policy as to securing the observance of its resale prices, and have been furnished with copies of letters addressed to customers by respondent bearing on this subject in the agents' respective territories, and its agents have, at its direction and as part of their business relations to respondent, advised customers of respondent's resale prices and its terms of dealing or refusing to deal in respect thereto, and have conferred with customers and prospective customers as to their observance of such resale prices in the future, and reported to respondent agreements secured from dealers that they would observe such resale prices. . . . .

Respondent upon numerous occasions instructed its agents to watch the merchandising methods of customers of respondent, in order to see that respondent's rules and requests were being complied with.

Lamont, Corliss & Company, of New York, agents of respondent, were asked by respondent to advise it should John T. Connor Company, of Boston, Massachusetts, which had been accepted as a customer by respondent, fail to observe respondent's suggested or requested resale prices for Cream of Wheat. . . . .

On August 3, 1921, respondent instructed its Portland agents, Ariss, Campbell & Gault, as follows:

> We will, of course, expect you to keep in close touch with the situation in that territory and immediately advise us in the event those customers or any other of our customers do not see fit to comply with our request as to the resale of our product to their retail customers. . . . .

On March 4, 1921, respondent notified Mason-Ehrman & Company, Portland, Oregon, that so far as respondent knew, its Portland agents, Ariss, Campbell & Gault:

> Where they do run up against a failure on the part of any of our customers to comply with our request for observance of minimum resale prices with regard to the resale of "Cream of Wheat," they have advised us promptly. . . . .

On April 15, 1921, Ariss, Campbell & Gault, of Portland, Oregon, agents of respondent, indicated they were interesting themselves in bringing to the attention of respondent cases of failure to maintain respondent's requested or suggested minimum resale prices. . . . .

On September 30, 1921, respondent instructed its agents, Bradley-Kuhl Company, of Los Angeles, California, to keep in close touch with and advise respondent as to why failure to comply with respondent's requests. This was in connection with resale price maintenance. . . . .

Par. 30. Respondent has utilized cooperative methods by which it has solicited and secured from customers or prospective customers themselves, or from other dealers or trade associations, information and reports as to whether or not such customers or prospective cus-

tomers have maintained and are maintaining, or are disposed to maintain generally resale prices fixed by producers, or respondent's resale prices in particular; and solicited and secured reports from customers, of customers who failed to observe its resale prices, and has investigated and verified such reports through further reports secured from customers as to such instances of price-cutting, all with a view to refusing further sales to customers found to have cut its resale prices. Respondent has sought and secured agreements and understandings with customers and prospective customers that they would observe the resale prices designated by it. Respondent has sought and secured agreements, understandings and assurances from customers, including chain stores, and from the National Chain Store Grocers' Association, that they would cooperate with it in securing the observance of its resale prices.

Respondent from time to time addressed to prospective customers, form letters or questionnaires containing, among others, inquiries whether it was their policy to maintain strictly resale prices; and has from time to time addressed circular or uniform letters to customers in different cities or sections (Pittsburgh, Washington, Texas, California) where it had information price-cutting existed calling attention to such reports and inviting more or less directly statements as to whether those addressed had [cut] or were at the time cutting prices. In December, 1921, respondent addressed such a letter to wholesalers in Pittsburgh, Pennsylvania, and Washington, D. C., referring to reports of price-cutting, disavowing any desire for agreement of observance of its resale prices, stating that in case of price-cutting "we will undoubtedly refuse to sell such customers any further quantities of Cream of Wheat," and concluding, "In order that there may be no question about this matter, will you please write us, upon your receipt of this letter, and advise us definitely whether you now are [selling], or have in the past sold, Cream of Wheat to your retail trade at a price less than that requested of you by us." In cases where an early response was not forthcoming, respondent wrote again asking for a reply. Those inquiries resulted in assurance in some cases of observances of respondent's resale prices and cooperation in their maintenance. . . . .

Par. 31. On complaint of competitor customers, respondent cut off price-cutter customers' supplies of Cream of Wheat and refused further to sell Cream of Wheat to such price-cutter customers because such customers sold Cream of Wheat below suggested or requested minimum resale prices named by respondent.

In June, 1922, respondent refused to sell Cream of Wheat to N. M. Crawford & Son, wholesale grocers of Coleman, Texas, who had theretofore been supplied, because a competitor of Crawford & Son complained of them as price-cutters on Cream of Wheat; and Crawford & Son acknowledged that they had sold Cream of Wheat at a price below that requested by respondent as a resale price. . . . .

On complaint of B. Kotz & Son, a competitor, that Mazo Brothers Company, of Washington, D. C., was a price-cutter as regards Cream

of Wheat, respondent in January, 1922, refused to sell Mazo Brothers Company, giving as a reason that it had failed to observe in the sale of Cream of Wheat the resale prices suggested or requested by respondent. . . . .

On complaint of a competitor of Snyder-Miller Company, wholesale grocers, of Washington, D. C., that the company was price-cutting in the sale of Cream of Wheat, respondent, in January, 1922, refused to sell Snyder-Miller Company upon the ground that in selling Cream of Wheat the Snyder-Miller Company had not observed the resale minimum prices suggested or requested by respondent. . . . .

On a complaint of a competitor of the Augusta Grocery Company, of Augusta, Georgia, that such company was a price-cutter with regard to Cream of Wheat, respondent refused, March 3, 1921, to sell any more Cream of Wheat to the Augusta Grocery Company, which had theretofore been supplied with the product, giving as a reason that the Augusta Grocery Company had failed to observe the resale prices suggested or requested by respondent. . . . .

On November 23, 1920, on complaint of a competitor of John H. Wilkins Company, wholesale grocers of Washington, D. C., who charged the Wilkins Company with price-cutting in the sale of Cream of Wheat, respondent refused to sell any more Cream of Wheat to John H. Wilkins Company, giving as a reason that in the sale of this product John H. Wilkins Company had failed to observe the resale prices suggested or requested by respondent. John H. Wilkins had been placed upon respondent's customers list about a month previous to that time after careful investigation by respondent's New York agents. . . . .

Par. 32. On complaint of competitor customers, respondent refused to sell supplies of Cream of Wheat to price-cutter customers at the same prices and terms upon which it sold its product to customers who observed its suggested or requested minimum resale prices. Respondent placed such price-cutter customers upon probation, while penalizing them as to prices charged to them for Cream of Wheat. If after probation over a period the price-cutter customers had shown that they had reformed and had observed respondent's suggested or requested minimum resale prices on Cream of Wheat, respondent reinstated them upon the understanding that they should continue to observe such resale prices.

February 7, 1921, upon information secured from Ariss, Campbell & Gault, sales agents at Portland, Oregon, that Mason-Ehrman & Company, wholesale grocers, had sold Cream of Wheat at $8.75 a case, while the resale price named by respondent was $9 a case, respondent refused to sell further supplies of Cream of Wheat to Mason-Ehrman & Company, which it had theretofore supplied, giving as its reason that Mason-Ehrman had not observed the suggested or requested minimum resale price named by respondent on its product. . . . .

On March 18, 1921, respondent offered, through its agents at Portland, Oregon, to place Mason-Ehrman & Company upon probation for

six months; that is, to supply them Cream of Wheat but at an advance or penalty of 35 cents a case over the regular price to competing wholesale customers who had not cut the resale price of Cream of Wheat. The offer was also made to Carr & Preston, wholesale grocers of Portland, Oregon, cut off by respondent on complaint of Mason-Ehrman & Company that Carr & Preston, too, were price-cutters. . . . .

Carr & Preston accepted the probationary conditions imposed upon them by respondent and were reinstated as probationers at an advance price upon respondent's list of customers in August, 1921. . . . .

Allen & Lewis, wholesale grocers of Portland, Oregon, also complained of by Mason-Ehrman & Company, their competitor, as price-cutters as to Cream of Wheat, were refused May 18, 1921, further sales of its product by respondent, who gave as a reason such resale price-cutting by Allen & Lewis. Respondent also offered to sell Allen & Lewis on probation at an advance price of 35 cents a case. . . . .

Respondent, through its agents Ariss, Campbell & Gault, in July, 1921, entered into an understanding or agreement with Carr & Preston and with Mason-Ehrman & Company, wholesale grocers of Portland, Oregon, by which they undertook to maintain respondent's requested or suggested minimum resale prices in the sale of Cream of Wheat as a condition of being able to purchase from respondent future supplies of Cream of Wheat at prices charged wholesalers who maintained respondent's resale prices. . . . .

Both Carr & Preston and Mason-Ehrman & Company were restored as customers by respondent August 3, 1921, on the same basis as other wholesale customers. . . . .

Respondent, in June, 1921, having learned that it was the Eugene Branch of Allen & Lewis which was price-cutting on Cream of Wheat, and that the Eugene Branch was independent, reinstated Allen & Lewis, of Portland, Oregon, on its list of customers to be sold at usual wholesale prices and suspended Allen & Lewis, of Eugene, as price-cutters. . . . .

Meantime, Allen & Lewis, of Eugene, were placed by respondent upon the probationary list as price-cutters instead of Allen & Lewis, of Portland, and were obliged to pay 35 cents a case extra for Cream of Wheat until they had expiated their offense. . . . .

On May 23, 1915, respondent suspended Lux Mercantile Company, of Topeka, Kansas, for price-cutting and placed this company on its probationary list for six months, requiring it to pay the price charged retailers for Cream of Wheat. In June, 1917, because this probationer had observed respondent's suggested or requested resale prices on its product for a year, respondent reinstated the Lux Mercantile Company on its list of wholesale customers who might buy at prices to wholesalers who were not price-cutters, with an agreement or understanding that the Lux Mercantile Company would thereafter, in the sale of Cream of Wheat, observe respondent's requested minimum resale price. . . . .

Par. 33. Respondent asked customers to inform it of price-cutting on Cream of Wheat by competitors of these customers, and promised to cut off such price-cutters. Respondent received and acted upon such information.

On April 17, 1922, respondent wrote Berdan Company, of Cleveland, Ohio, which it had cut from its list of customers because of failure to maintain respondent's requested or suggested resale prices in the sale of Cream of Wheat, to furnish it with proof of like price-cutting by Berdan Company's competitors, which proof was later sent as to Feilbach Company, of Toledo, Ohio. . . . .

On April 9, 1919, respondent, by letter, solicited from Philip Becker & Company, of Buffalo, New York, information as to price-cutting of Becker Company's competitors in the sale of Cream of Wheat, and promised to cut from respondent's list of customers any such price-cutters. . . . .

Par. 34. Respondent systematically notifies, and has notified, prospective customers of Cream of Wheat of its policy looking toward maintenance of its suggested or requested resale prices in the sale of its product. Such notification is in such terms as to indicate that this is a condition which must be complied with if the customer wishes to continue to purchase supplies of Cream of Wheat from respondent.

. . . .

Par. 35. When respondent secured, through advertisements, price-lists, agents, customers, or from other sources, information of price-cutting by its customers in the resale of Cream of Wheat, it wrote letters reiterating its policy that it would refuse to sell to a customer further supplies of Cream of Wheat should the customer fail to respect or adhere to respondent's suggested or requested minimum resale prices. In some instances, if the information was verified, it cut off the customer at once; in others, respondent requested expressions by customers as to whether they were adhering to respondent's suggested or requested resale prices, or whether they intended to adhere to such prices; or expressions both as to whether they had adhered to such prices and whether they intended to adhere to such prices. Where customers were thus cut off, refusal to comply with respondent's requested or suggested resale prices was usually given as the reason for such cutting off.

. . . .

Par. 36. Respondent has refused to modify its demand as to the observance by its vendees in the sale of Cream of Wheat of the minimum resale prices suggested or requested by respondent, even where the vendee maintained he was not giving such service as would warrant the margin which such resale price would give such vendee, and that it would mean essentially higher prices to consumers than were charged in the service stores and would entail undue profit to the retailer.

. . . .

Par. 37. Respondent, for sales direct from its Minneapolis office, and after February, 1921, for practically all its sales, probably through

stenciled numbers on its shipping cases, had a means of tracing the shipments of Cream of Wheat to dealers who had failed to adhere to its resale prices, or had supplied Cream of Wheat to dealers refused sales because of selling below respondent's resale prices, or had failed to observe its request not to divide shipments with others. . . . .

Cream of Wheat is subject to deterioration with age but the extent of such deterioration, or the period the product remains fresh, has not been fixed by evidence in this proceeding. Respondent replaces damaged or deteriorated goods with fresh goods. The stenciled numbers placed upon packing cases of Cream of Wheat serve to identify the contents of such cases as to the date of preparation at the factory and in that way aid respondent in knowing whether its products have reached consumers with sufficient promptness to insure their being fresh and in good condition. Stenciled numbers have been used for this purpose.

Par. 38. Among other features of respondent's policy and practices regarding resale prices stated by respondent's president and general manager in the correspondence with the National Chain Store Grocers' Association . . . . is the following: After stating that in case a customer sells Cream of Wheat at less than the requested resale price, respondent refuses to fill any of his future orders, "In addition to the above, will say, in case that any wholesale customer of ours does not see fit to comply with our request with regard to resale price, and as a consequence we refuse sales to him, we notify all of our other customers within a certain radius of our action in the premises, and request them in turn not to sell any of our goods to the party to whom we have refused sales. If any of our other customers last above alluded to, do not see fit to comply with our request, but do resell our goods to the party to whom we have refused sales, we in turn refuse to sell to the party reselling our goods to the party to whom we have requested them not to sell." (Letter of respondent's president, March 26, 1921); likewise after stating that if any of the chain store branch stores "for any reason whatever, sold Cream of Wheat for less than our requested price, we would certainly refuse to sell that branch, and all the other stores of your company, any further quantity of Cream of Wheat," respondent adds: "and, in the event we did so refuse to sell your company Cream of Wheat we would undoubtedly so advise all the other companies in your association, as well as wholesalers in your territory. And in advising them of our refusal to sell you, we would request them not to resell Cream of Wheat. In the event they did sell you Cream of Wheat, contrary to our request, we would refuse to sell them further quantities of our product." (Letter of D. F. Bull, treasurer, April 22, 1921.) President Mapes' letter of March 26, 1921, makes the foregoing apply to all respondent's customers by the clause quoted in the preceding finding.

Respondent admitted . . . . that it "advised other customers, in some cases, that respondent had refused further sales to customers

because of price-cutting, suggesting that 'in the general interest of the trade it would be good policy for you to decline filling any orders' from them, and that 'it would be for your best interests to decline to fill any orders for Cream of Wheat which they may see fit to place with you'; and in some cases declaring, variously, that if customers refuse to observe this request, respondent 'refuses to sell' or would refuse or intended to refuse to sell such customers; and in at least one case respondent refused further sales to a customer because he had sold Cream of Wheat to another customer to whom respondent had refused to sell because of price-cutting." No case of such refusal to sell appears in the record.

All these practices and policy as stated by respondent's president and general manager, and as indicated in his letter of March 26, 1921, are reiterated substantially by Mr. Bull, as treasurer, in his letter to individual chain stores of the National Association (letter of April 22, 1921). In this letter Mr. Bull adds: "We have gone into this matter at length, as, in the event we make a connection with your company we want you to be thoroughly familiar with our selling policy. This policy we have maintained for a good many years, and is one we intend to maintain so far as we legally can in the years to come."

Par. 39. After having stricken from its list of customers dealers who had failed to maintain respondent's suggested or requested resale prices in the sale of Cream of Wheat, respondent has, by means of letters or through its agents, notified other dealers of its action and requested other dealers not to sell Cream of Wheat to the customers thus cut off, reenforcing respondent's request by an intimation or a threat that such sales to the rejected dealer would result in the seller also being cut off from supplies of Cream of Wheat by respondent.

. . . .

On February 15, 1921, respondent refused to sell Cream of Wheat to Cobb, Bates & Yerxa, of Boston, Massachusetts, which it had theretofore been supplying with that product, giving as a reason that those dealers had failed to observe respondent's requested or suggested resale prices in the sale of Cream of Wheat. Immediately thereupon respondent addressed letters to several wholesale dealers in Cream of Wheat telling them of respondent's having cut from its list of customers Cobb, Bates & Yerxa Company, and suggested that:

> It would be for your best interests to decline to fill any orders for "Cream of Wheat" which they may see fit to place with you.

. . . .

Early in 1921, respondent cut from its list of customers for Cream of Wheat Mason-Ehrman & Company, of Portland, Oregon, wholesalers whom it had theretofore been supplying with that product. They had failed to observe respondent's suggested or requested resale prices in the sale of Cream of Wheat. February 7, 1921, respondent wrote to its agents in Portland, Ariss, Campbell & Gault, that:

It might be well for you to advise all the other jobbers of Portland of the action we have taken in this matter, so that they will thoroughly understand our wishes with regard to resale price must be respected or we shall exercise the option of refusing to sell those who do not consider it advisable to comply with our request. . . . .

Similar action was taken with regard to Carr & Preston, wholesalers, of Portland, Oregon. . . . .

Respondent announced repeatedly to its customers that it would refuse to supply Cream of Wheat to customers who supplied price-cutters . . . .

Par. 40. In some cases, dealers or associations of dealers have collected for respondent data as to whether its suggested or requested minimum resale prices were being maintained and aided in circulating statements as to its policy of minimum resale price control in the sale of Cream of Wheat and aided in enforcing that policy. . . . .

Respondent cooperated with the Iowa-Nebraska-Minnesota Grocers' Association in sending to the members of that association, in the form of a circular letter of the association, a portion of a letter from respondent to H. A. Marr in which was set forth respondent's resale price maintenance policy and the consequence of failure by dealers to observe and adhere to such policy. This was accompanied by a warning paragraph from John Mehlhop, Jr., secretary and treasurer of the association, admonishing members against doing the thing that H. A. Marr, grocer, had done. . . . .

Immediately before sending out the association's circular as to Cream of Wheat resale price maintenance, Mr. Mehlhop made specific inquiry of some of the Iowa-Nebraska-Minnesota Wholesale Grocers' Association's members as to whether they were getting full list prices for Cream of Wheat, and he received some replies that they had not been doing so.

After receiving the circular, some of these wholesale grocers insisted upon list prices, stating that they had done so as a consequence of what was set forth in the association's letter. . . . .

In some cases respondent secured the cooperation of associations and dealers in determining in advance of its accepting orders from a prospective customer whether such prospective customer was a price-cutter or whether he would adhere to respondent's suggested or requested minimum resale prices in the sale of Cream of Wheat.

. . . .

Par. 41. Resale price maintenance has been for years the special sales policy of respondent in the sale of Cream of Wheat. It has been aggressively asserted. When information had come to respondent that any vendee had failed to adhere to such policy, respondent has ordinarily adopted effective means of enforcing such observance through methods and agencies hereinabove set forth.

The methods found in paragraphs 24 and 28 to 40, inclusive, above,

to have been used by the respondent involve and require continuous cooperation and concert of action between and among respondent and its distributors, customers and agents; and these methods constitute cooperative methods employed to procure the sale by dealers of respondent's product at prices named by the respondent and methods by which respondent, its distributors, customers and agents undertake to prevent others from obtaining the respondent's product at less than the minimum resale price designated by it.

Such policy has not been changed although the methods of stating such policy and methods of enforcing such policy have been modified so as to be less direct. Since February, 1922, respondent has been less aggressive in its enforcement of its requested or suggested minimum resale prices for the sale of its product. . . . .

Par. 42. Respondent has had upon its books 6,500 live customers between January 1, 1913, and December 20, 1922. Of this number it has ceased to sell 2,000. Evidence in this proceeding shows that 53 were eliminated for failure to observe and adhere to respondent's suggested or requested resale prices, and of these 24 were later reinstated by respondent. It is not established by competent evidence in this proceeding that a greater number than 53 customers were eliminated for such failure to observe respondent's resale prices, nor is it established by competent evidence in this proceeding that a greater number were not eliminated for such reason.

Par. 43. In connection with the subject of respondent's practices as to cutting off of customers because of their cutting its resale prices, respondent's counsel offered in evidence the report of an employee, the witness Warren, general office manager of the respondent since September, 1920, of the result of an examination of all the company's office files covering the history of its transactions from 1913 to 1922, with customers with whom it had ceased, for any reason, to do business during that period. This examination, which consumed two or three months, was made by Warren and employees of respondent under him (boys in the office and a former woman employee . . . .) under the general direction of Mr. Bull, the general manager. This report purported to give in tabulated form the number of customers with whom respondent had ceased to do business with reasons therefor, including those subsequently reinstated. The latter involved an examination of all its files of existing customers, as well as all old files of discontinued customers, numbering together four or five thousand. These files consisted of so-called "ticklers," comprising, in separate packages for each customer, the records and correspondence relating to his standing as to sales, and so forth, and including a miscellany of papers and more or less voluminous. . . . . The witness Warren, or those under him who prepared the report, had no part in the policy or management of respondent's business or sales. The reasons for discontinuance of sales, Warren and Bull testified, appeared generally on the face of the files, that is, in memoranda readily understood. Doubtful

cases were referred to Mr. Bull or Mr. Thompson, the secretary. The files, Warren testified, were in unsatisfactory shape when he took employment with respondent in 1920, and the "tickler" files did not contain all the information necessary as to those customers prior to that time. The report as offered in evidence purported to show that there were 53 cases in which further sales were refused because of cutting of respondent's resale prices; 24 cases of reinstatement after refusals to sell because of such price-cutting; 360 cases, because customers were not wholesalers according to respondent's standards; 1,938 cases where respondent had ceased selling because dealers had gone out of business; 84, because dealers had retail connections; 71, because dealers were chain stores or buying associations; 29, because they involved drop shipments; 17, because dealers had ceased to handle cereals; and 5, because dealers had a storage plant only. . . . . The report also purported to show 77 cases in which respondent had taken no action where cutting of respondent's resale prices appeared. This evidence was objected to, for establishing the entire number of refusals to sell by respondent for price-cutting, but not as showing the report of respondent's investigators. A motion was made to strike on the grounds that the evidence, as offered, was not the best evidence which was available in the files themselves and involved conclusions as to matter not within the knowledge of the witness, and, as to the parts of report as to cessations of sales not involving any question of price-cutting, that they were irrelevant and immaterial. The offer as to cases where no action was reported to have been taken for price-cutting was specifically objected to as a conclusion and not admissible when the files themselves were available. These objections were sustained by the examiner who, however, expressly ruled that the testimony of the witnesses Bull or Warren so far as they testified on the subject of refusals to sell because of price-cutting, of their own knowledge, should be received.

While the Commission regards the objection of counsel, tested by the rules of legal evidence, as well taken, it has nevertheless taken all this evidence into consideration and given it such weight as it seems entitled to in the light of the other evidence spread on the record in the correspondence, exhibits and elsewhere as to the policy and practices of respondent, and particularly the written statement reiterated by respondent's president and general manager that cases of refusal to sell for price-cutting numbered many hundreds and the testimony of the Commission's examiner who examined respondent's files, that he spent two or three weeks only in "delving into" the files and that he estimated a complete examination would have taken six months, and the results of his examination in the matters in question, in Commission's exhibits.

Whatever be the evidence and the fact as to the number of instances of respondent's cutting off dealers because of their cutting its resale prices, the Commission does not regard it, standing alone, as of decisive or, therefore, important character. The more effective any system of resale price maintenance, the fewer the occasions to withhold sales because of price-cutting. It would naturally not be resorted to except

as a means to maintain that system, as the main purpose always is to sell goods and not decline sales.

The respondent systematically represented to customers and prospective customers that it would refuse further sales to those who cut its resale prices and it did so when it judged it necessary to its general policy of maintaining its resale prices.

In January, 1922, the respondent advised its agents in San Diego, California, referring to reports from them of price-cutting, that, if verified, "we will refuse to sell them (jobbers) our product if we have to cut off the whole city of San Diego."

Par. 44. Respondent's notification of and request for observance of its minimum resale prices are addressed by it to its vendees, wholesalers or retailers only, as distinguished from vendees of those vendees.

Par. 45. Respondent's policy of naming and enforcing adherence to minimum resale prices for its product, by the methods above set forth, has had the capacity and tendency, and has had the effect so far as enforcement has been successful, of substantially lessening and curtailing price competition among wholesale and retail customers, distributors of Cream of Wheat, and to enhance the price thereof and to prevent the consuming public from getting the benefit from efficiency of operation on the part of more efficient dealers.

Par. 46. Respondent's policy of resale price maintenance by the methods above set forth has had the tendency and effect, as far as successful, in connection with the dominant position of Cream of Wheat in the market for purified middlings in package form, of lessening and curtailing price competition among distributors of package cereal foods prepared from purified middlings and to enhance the price of such package cereal foods to consumers. . . . .

Par. 47. Respondent's policy of naming and enforcing adherence to minimum resale prices for its product, taken in connection with its nation-wide advertising and its dominating position in the market for package cereals having as a base or raw material purified wheat middlings, has had the capacity and tendency, and in so far as its enforcement was successful, has had the effect of substantially lessening or curtailing price competition among producers of package cereal foods prepared from purified wheat middlings and to enhance the price of such package cereal foods to consumers and thus increase the cost of living. . . . .

Par. 48. Respondent's resale prices for Cream of Wheat are based upon margins of cost of doing business averaged for individual stores which give customers credit and maintain delivery, telephone, and like services. . . . .

Respondent, in naming and enforcing such resale prices, lessens, curtails, and prevents substantial competition between chain stores, vendees of respondent, and between such chain stores and other retail dealers, and it causes prices of such vendees to consumers to tend toward

uniformity at or above the minimum resale prices named by respondent, and prevents chain stores from offering Cream of Wheat at the lower prices which such stores could afford to ask because of lower operating expenses, and prevents consumer customers of these stores from securing such lower prices as might be secured were such chain stores free to name their own prices for the sale of Cream of Wheat, without interference from respondent, and makes such consumer customers to pay for service which they have not asked for and have not received. . . . .

Par. 49. Prices at which Cream of Wheat was sold to consumers by retailers, whether or not vendees of respondent, have tended toward the minimum requested or suggested resale prices named by respondent or the prices higher than such suggested resale prices. Average resale prices for Cream of Wheat set forth in the monthly *Labor Review* for August, 1922, for about fifty cities in the United States, show that the averages for July 15, 1921, were at or above respondent's resale prices in about 36% of the averages given and below 64% of such averages; May 15, 1922, at or above in about 75% of the averages given and below in about 26%; June 15, 1922, at or above in about 77% of the averages given and below in about 23%. . . . .

The averages as given in the monthly *Labor Review* were founded upon reports of from 10 to 26 retail stores in each of the cities reporting, some of which might have been chain stores. . . . .

Such figures were not reported in sufficient detail in the *Review* to determine the percentages of agreement and disagreement of individual prices or individual sales. A single departure from round price figure like 30 cents or 25 cents, the resale prices named at the period tabulated, would make the average figure deviate from the round figure unless a compensating deviation occurred in the opposite direction, so that the figures showed only that in the percentages of sales given the average prices were at, or above or below, the resale prices named by respondent. Departures of the average figure from the resale price figures were usually slight. The respondent did not consider it a violation of its request should a customer sell above its suggested resale price. . . . .

Par. 50. Respondent's policy of naming and enforcing the minimum resale prices to wholesale dealers had a tendency to cause such resale prices to remain uniform at the resale prices suggested or requested by respondent, and so far as successful did bring about such uniformity and the total failure of price competition among such wholesale dealers. There were departures from such suggested or requested resale prices. . . . .

Par. 51. Prices of Cream of Wheat less than the minimum price named by respondent to its vendees, whether dealers at retail or dealers at wholesale, were not so low as to involve a loss to the dealer but were satisfactory to the dealer in cases where respondent had refused to sell or had cut off the dealer as a customer for Cream of Wheat for

the reason that such dealer was cutting such requested, or suggested resale prices. Respondent's policy has been applied by respondent to price-cutting generally and not confined to cases where Cream of Wheat has been used as a "leader" or a "lure." . . . .

Par. 52. Incidental to its policy of resale price maintenance, respondent has maintained uniform delivered prices for Cream of Wheat. Such uniform delivered prices have the capacity and tendency of lessening competition in commerce and of increasing prices and living costs, and are discriminatory and economically unfair as between customers of respondent. . . . . In adopting and enforcing its policy of making delivered prices on its product uniform throughout the United States, the respondent does not treat its customers equitably, and its policy tends to enhance prices for its product to the consuming public. . . . .

Par. 53. Respondent's policy of naming and enforcing resale prices in the sale of Cream of Wheat has the capacity and tendency to prevent and, when successful, has had the effect of preventing the distribution of its product through the channels through which it would flow under conditions of free competition. . . . .

Par. 54. The naming and enforcing of resale prices on nationally advertised articles sold in the grocery trade is not the usual nor general practice but on the contrary is exceptional and unusual, and respondent's practice in this respect is unique in its particular field. . . . .

Par. 55. The correspondence of respondent with its customers and agents put in evidence by the Commission, forming the bulk of the documentary evidence . . . . on which the foregoing findings are based, was the result of an examination of only a fraction of such correspondence in respondent's files. The Commission's examiner who made the investigation spent about two weeks examining respondent's correspondence files and estimated that the examination of all of them would have consumed six months. The examiner referred to testified that he delved in the files, selected a number of cases which he thought were representative, following up cross-references relating to resale price practices, and stopped when he thought he had developed what was respondent's sales policy. . . . .

Par. 56. In connection with the examination of the respondent's chief witness Clifford, counsel for respondent offered in evidence, as part of his testimony, a paper prepared by the witness, which counsel designated as an "opinion." Objection was made to this form of evidence on the grounds that the paper in question was largely argumentative and dealt with conclusions, which it was the Commission's province to make, and that the witness had not qualified as an expert for the scope of the questions discussed in the paper, and that the proper form of his evidence was question and answer, with opportunity for objections and cross-examination. This objection was sustained by the examiner on the grounds that the witness had not qualified as an expert for the scope of the subjects discussed in his paper and on the other grounds

urged. The paper in question, however, was later introduced and spread on the record occupying 20 pages. . . . . The Commission regards the examiner's ruling as sound and finds that the paper was properly described as an "opinion" and that it dealt largely in arguments and conclusions as to the subjects for the Commission's decision, and should properly have been reserved for argument by counsel. The Commission has, however, considered the contents of this paper in reaching its conclusion and has respected this expression of opinion from the point of view of the witness.

Par. 57. The Cream of Wheat Company agreed in writing, by letter dated December 6, 1920, that in the event of a readjustment in the price of Cream of Wheat, it would protect its jobbing customers against a decline in price, such protection, however, not to exceed the jobber's direct purchases for a period of 30 days prior to the issuance of price reduction circular, and such protection to apply only on stock of Cream of Wheat actually on hand or in transit at the time of the issuance of the price reduction circular, such guarantee to hold good until the first of June, 1921, unless previously abrogated; and that from time to time such agreement was extended up to February 1, 1922; that on December 11, 1922, the Cream of Wheat Company, by letter of that date, agreed to protect its customers against a decline in price, such protection, however, not to exceed the customer's direct purchases from the company invoiced within a period of 30 days prior to December 16, 1922, and to apply only to the stock of Cream of Wheat actually in the customer's hands or in transit to the customer on December 16, 1922.

Par. 58. Referring to the resale prices named by respondent for wholesalers and retailers as stated in paragraphs 17 and 18 above, and as showing the relations of the margins, or price mark-up, represented by such resale prices compared with the cost of doing business, and the range of such operating costs, by wholesale and retail grocers, the following figures are admitted as a basis for judging the price competition normally existing and the interference or restraint of it, which the minimum uniform resale prices requested by respondent represent:

(*a*) Such resale prices for wholesalers were approximately 10% more than the prices paid to respondent by such vendees who purchased in less than carload lots, and approximately 12½% to 14% more than the prices paid to respondent by such vendees who purchased in carload lots.

Computing on the basis of such resale prices, the margins between the prices paid to respondent by its vendees and the prices for resale by such vendees were 9⅓% for less-than-carload lots and 11 1/10% to 12 2/9% for carload lots.

(*b*) According to the report of the Joint Commission of Agricultural Inquiry, Part No. 4, "Marketing and Distribution," submitted to Congress October 15, 1921, the average cost of operating wholesale grocery

stores in this country for the years 1916 to 1921, in terms of percentages of sales receipts (the same basis as the last paragraph above), was as follows:

Year	Percentage	Year	Percentage
1916	8.48	1919	8.42
1917	8.49	1920	8.52
1918	8.68	1921	10.16

According to the same report the average cost of operating retail grocery stores for the same period stated in percentages of sales receipts was as follows:

Year	Percentage	Year	Percentage
1916	15.20	1919	14.20
1917	15.50	1920	14.60
1918	14.30	1921	16.80

(c) According to Bulletin No. 9 of the Harvard Bureau of Business Research, *Operating Expenses in Wholesale Grocery Business*, chiefly for the year 1916, total operating costs ranged from 6.7% to 13.74% of sales receipts, the common figure being 9.5%.

According to Bulletin No. 14 of the same Bureau for the year 1918, total operating costs of wholesale grocers ranged between 6.15% and 14.79%, the common figure being 9.1%.

According to Bulletin No. 19 of the same Bureau for the year 1919, the total operating costs of wholesale grocers ranged between 4.35% and 14.71%, the common figure being 9.1%.

According to Bulletin No. 26 of the same Bureau for the year 1920, operating costs of wholesale grocers ranged from 5% to 17.4%, the common figure being 9%.

For the retail grocery business, according to the Bulletin No. 5 of Harvard Bureau, 1915, operating costs ranged from 10.4% to 25.2% of sales receipts.

According to Bulletin No. 18, 1919, the operating costs of the retail grocery business ranged from 6.57% to 25.35% of the sales receipts, the common figure being 14.6%.

"The common figure" is defined by the Bureau as follows:

> The common figure in each case is the one around which the figures from all the wholesalers center. It is the predominant, typical or most frequent figure—the one that is used by wholesale grocers as a standard with which to compare their own results. (Bulletin No. 9) . . . .

Retailers: (a) When the resale price (wholesale) was $4.50 a case (prior to Sept. 16, 1916), the respondent's sale price to retailers, as well as wholesalers, was $3.95 for carload lots and $4.10 for less-than-carload lots. On the basis of $3.95, the cost per unit package to the retailer (36 packages to the case) was 11 cents, leaving a margin of

3 cents between that and the retail resale price of 14 cents, or 27.2% of the purchase price and 21.43% of the resale price.

On the basis of $4.10 a case, or 11.388 cents a package, the margin was 2.612 cents, or 22.93% of the purchase price and 18.657% of the resale price.

When the resale price (wholesale) was $7.50 a case (April, 1917, to November, 1919) the respondent's sales price to retailers and wholesalers alike was $6.65 for carload lots and $6.80 for less-than-carload lots.

On the basis of $6.65 per case, the cost per unit package to the retailer was 18.47 cents, leaving a margin of 6.53 cents or 35.35% of the purchase price, and 26.12% of the resale price.

On the basis of $6.80 a case, or 18.88 cents a package, the margin was 6.12 cents, or 32.41% of the purchase price, and 24.4% of the resale price.

When the resale price (wholesale) was $9 a case (November, 1919, to December, 1921) respondent's sales price to retailer and wholesaler alike was $8 for carload lots and $8.15 for less-than-carload lots.

On the basis of $8 a case, the cost per unit package was 22.22 cents, leaving a margin of 7.8 cents, or approximately 35% of the purchase price and 25.93% of the resale price.

On the basis of $8.15 a case, or 22.64 cents a package, the margin was 7.36 cents a package or 32.39% of the purchase price, and 24.56% of the resale price.

(*b*) When the resale price for the wholesaler who bought in less-than-carload lots was $4.50 a case, the margin between such price and the price to the wholesaler who bought in carload lots at $3.95 a case was 55 cents a case, or 12.22% of the resale price in percentages of sales receipts; and the margin between such resale price and the price to the wholesaler who bought in less-than-carload lots at $4.10 a case was 40 cents a case, or 8.88% of the resale price.

When the resale price for the wholesaler who bought in less-than-carload lots was $5.40 a case, the margin between such price and the price to the wholesaler who bought in carload lots at $4.75 a case was 65 cents a case, or 12.07% of the resale price in percentages of sales receipts; and the margin between such resale price and the price to the wholesaler who bought in less-than-carload lots at $4.90 a case was 50 cents, or 9.26% of the resale price.

When the resale price for the wholesaler who bought in less-than-carload lots was $7.50 a case, the margin between such price and the price to the wholesaler who bought in carload lots at $6.65 a case was 85 cents, or 11.33% of the resale price in percentages of sales receipts; and the margin between such resale price and the price to the wholesaler who bought in less-than-carload lots at $6.80 was 70 cents, or 9.33% of the resale price.

When the resale price to the wholesaler who bought in less-than-carload lots was $9 a case, the margin between such price and the

wholesaler's price who bought in carload lots at $8 a case was $1, or 11.11% of the resale price in percentages of sales receipts; and the margin between such resale price and the price to the wholesaler who bought in less-than-carload lots at $8.15 a case was 85 cents, or 9.44% of the resale price.

Par. 59. As a result of respondent's policy of resale price maintenance, and other elements of its distributive merchandising system, respondent has been able to maintain the following margins between the prices of its raw materials and its lowest selling prices, its prices for sales in car lots.

The following figures as to the margin between the cost of purified middlings and prices for Cream of Wheat are based upon the calculations made from prices of flour . . . . increased by $1 a barrel, which was the maximum price at any time for purified middlings. Averages were taken for different periods and compared with figures in the record. Flour and middlings were taken as 196 pounds to the barrel and Cream of Wheat at 63 pounds to the case and both reduced to a pound basis before comparisons were made. The evidence shows that Cream of Wheat consists wholly of purified middlings cleansed, sterilized by means of moderate heat and carefully packed in cartons.

(*a*) From January, 1913, to August 1, 1916, about 3.57 cents a pound, or about 132% of the price of purified middlings, was the largest average margin, and about 2.50 cents a pound, or about 66% of the price of purified middlings, the smallest. In other words, the price of Cream of Wheat in carload lots was 66% to 132% above the price of purified middlings.

At the same time the margin between respondent's price of Cream of Wheat to wholesalers and its suggested resale price to wholesalers was a trifle less than 14% of respondent's price.

The margin between respondent's carload-lot price to retailers and its suggested minimum resale price to retailers was 27.2% of respondent's price.

Ultimate consumers served by retailers who are direct vendees of respondent, in accordance with respondent's prices and suggested resale prices, paid a margin from 112% to 196% above the wholesale price of purified middlings for purified middlings sold under the name of Cream of Wheat from January 1, 1913, to August 1, 1916.

Ultimate consumers paid 8 cents a pound for purified middlings in the form of Cream of Wheat, while millers sold purified middlings at prices ranging from 2.7 cents to 3.77 cents a pound. In other words, the ultimate consumer paid at retail for purified middlings sold as Cream of Wheat 212% to 300% of the wholesale price for purified middlings.

(*b*) From September 14, 1916, to April, 1917, such margin was about 2.54 cents a pound, or about 50% of the price of purified middlings at wholesale. In other words, respondent's price for Cream of Wheat

in car lots was about 50% above the wholesale price of purified middlings.

At the same time the margin between respondent's price for Cream of Wheat to wholesale dealers and its suggested resale price for wholesale dealers was about 13.5% of respondent's carload-lot prices.

(*c*) From May to November, 1919, such margin was about 3.87 cents a pound, or about 58% of the price of purified middlings at wholesale. In other words, respondent's price for Cream of Wheat in carload lots was about 58% above the wholesale price of purified middlings.

At the same time the margin between respondent's price of Cream of Wheat to wholesale dealers and its suggested resale price for such dealers was about 12.8% of respondent's car-lot prices. The margin between respondent's car-lot price to retailers and its suggested minimum resale price for retailers was 35.35% of respondent's car-lot price.

Ultimate consumers served by retailers who bought direct from respondent, in accordance with respondent's prices and suggested resale prices, paid an average minimum margin of 113% above the wholesale price of purified middlings for purified middlings sold under the name of Cream of Wheat.

Ultimate consumers paid 14.27 cents a pound for purified middlings sold as Cream of Wheat, while millers sold purified middlings at wholesale at 6.68 cents a pound, or the retail price to consumers of Cream of Wheat was 213% above the wholesale price of purified middlings.

(*d*) From November 19, 1919, to December, 1921, such margin was about 6.85 cents a pound, or about 117% of the price of purified middlings at wholesale. In other words, respondent's price of Cream of Wheat in car lots was about 117% above the wholesale price of purified middlings.

At the same time the margin between respondent's price for Cream of Wheat to wholesale dealers and the suggested resale price for such dealers was about 12.5% of respondent's car-lot price. The margin between respondent's car-lot price to retailers and its suggested minimum resale price for retailers was 35% of respondent's car-lot price.

Ultimate consumers served by retailers who bought direct from respondent, in accordance with respondent's prices and suggested resale prices, paid an average minimum margin of 196% above the wholesale price of purified middlings for purified middlings sold under the name of Cream of Wheat.

Ultimate consumers paid 17.13 cents a pound for purified middlings sold under the name of Cream of Wheat while millers sold purified middlings at wholesale at 5.85 cents a pound, or the ultimate consumer paid 296% of the wholesale price of purified middlings.

(*e*) From December, 1921, to December, 1922, such margin was about 6.32 cents a pound, or about 149% of the price of purified middlings at wholesale. In other words, respondent's price for Cream of Wheat in car lots was about 149% above the wholesale price of purified middlings.

At the same time the margin between respondent's price of Cream of Wheat to wholesale dealers and its suggested resale price for such dealers was about 12.8% of respondent's car-lot price.

The margin between respondent's car-lot price to retail dealers and its suggested minimum resale price for retail dealers was 35.35% of respondent's car-lot price.

Ultimate consumers served by retailers who bought direct from respondent, in accordance with respondent's prices and suggested resale prices paid in this period an average minimum margin of about 237% above the wholesale price of purified middlings for purified middlings sold under the name of Cream of Wheat.

Ultimate consumers paid 14.27% a pound for purified middlings sold under the name of Cream of Wheat, while the millers sold purified middlings at wholesale for 4.23 cents a pound, or the ultimate consumers paid 337% of the price of purified middlings for Cream of Wheat.

(*f*) From December, 1922, to November, 1923, such margin was 5.80 cents a pound, or about 153% of the price of purified middlings at wholesale. In other words, respondent's price for Cream of Wheat in car lots was about 153% above the price of purified middlings.

Ultimate consumers served by retailers who bought direct from respondent, in accordance with respondent's prices and suggested resale prices paid in this period an average minimum margin of about 216% above the wholesale price of purified middlings for purified middlings sold under the name of Cream of Wheat.

Ultimate consumers paid 12 cents a pound for purified middlings sold as Cream of Wheat, while millers sold purified middlings at wholesale at 3.8 cents a pound, or the ultimate consumers paid 316% of the wholesale price of purified middlings for Cream of Wheat.

CONCLUSION

The practices of the said respondent, under the conditions and circumstances described in the foregoing findings, are unfair methods of competition in interstate commerce, and constitute a violation of the Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes."

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission, the answer of the respondent, and testimony and evidence submitted, the Trial Examiner's report upon the facts and exceptions thereto, and the Commission having made its findings as to the facts and its conclusion that the respondent has violated the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes."

Now therefore it is ordered that the respondent, Cream of Wheat Company, its officers, agents, employees and successors, do cease and

desist from carrying into effect its policy of securing the observance of minimum resale prices for its product, by cooperative methods in which the respondent and its distributors, customers and agents undertake to prevent others from obtaining the company's product at less than the prices designated by it, or from selling to others who fail to observe such prices—(1) by seeking and securing, directly or through its sales agents, contracts, agreements or understandings with customers or prospective customers that they will maintain the resale prices designated by it, or that they will cooperate with it to secure the observance by others of said resale prices; (2) by the practice of (*a*) soliciting and securing from customers or prospective customers themselves or from dealers or trade associations, information as to whether or not such customers or prospective customers have maintained and are maintaining, or are disposed to maintain generally resale prices fixed by producers, or, respondent's resale prices in particular, and (*b*) soliciting and securing reports from customers, of customers who fail to observe its resale prices, and investigating and verifying such reports through further reports secured from customers as to such instances of price-cutting, all with a view to refusing further sales to customers found to have cut its resale prices; (3) by notifying other customers, in case of refusal by respondent of further sales to price-cutters, of such refusal and requiring them not to sell such price-cutters on pain of themselves being refused further sales; (4) by employing its sales agents to assist in such plan by reporting dealers who have failed to observe its resale prices, and to secure adherence thereto from customers or prospective customers, and furnishing said agents the names of customers to whom it has refused further sales because of price-cutting, and instructing them not to sell to such customers; (5) by requiring an extra price for its product from price-cutters in order to secure from them assurance of their future observance of its resale prices as a condition of reinstatement on the regular basis; or (6) by utilizing any other equivalent cooperative means of accomplishing the maintenance of prices fixed by respondent.

It is further ordered, that the respondent, Cream of Wheat Company, shall within sixty days after the service upon them of a copy of this order, file with the Commission a report in writing setting forth in detail the manner and form in which they have complied with the order to cease and desist hereinbefore set forth.[4]

[4] The United States Circuit Court of Appeals for the Eighth Circuit reviewed and, with the exceptions noted below, affirmed this order of the Federal Trade Commission. 14 F. (2d) 40.

The court, after quoting the commission's order, gave the following opinion:

Counsel for petitioner frankly admitted in his able oral argument that, if the Commission was justified to make any order in the case, requiring the petitioner to desist from the practices set out, paragraphs 1, 3, and 5 are unobjectionable. Their objections are to paragraphs 2 (*a*) and (*b*) and paragraphs 4 and 6.

The objections to paragraph 2 (*a*) are that the petitioner construes it as directing petitioner to desist from securing from customers or prospective

COMMENTARY: Despite the company's disclaimers of intent to enter into agreements with its customers to secure the maintenance of resale prices, the practices set forth in this case were sufficiently similar to those condemned in the Beech-Nut case to warrant the expectation of an adverse decision. Such disclaimers are of little value and reliance cannot be placed on them for protection.

There were some grounds for differentiating this case from the Beech-Nut case, since the Cream of Wheat Company apparently dealt more with price-cutting by wholesalers than by retailers, and it did not maintain, perhaps, so elaborate a system of records for enforcing its policy. The numbering of the shipping cases facilitated the tracing of shipments of merchandise which had deteriorated, and therefore aided the company in controlling distribution so as to reduce the likelihood of deterioration, a worthy object which the commission did not condemn even though the numbers on the shipping cases had been used also to trace the sources of purchases of merchandise offered for sale at cut prices. The practices of the Cream of Wheat Company differed from

---

customers or from dealers or trade associations reports of customers who fail to observe its resale prices.

But the order does not warrant such an interpretation. The language is to desist from "soliciting and securing" from customers, and so forth, such information. Merely securing the information is not prohibited, unless the information is also "solicited." If the order had employed the disjunctive "or" instead of the conjunctive "and," counsel's contention would be entitled to greater consideration, a question not before us and not decided.

This order does not prohibit the petitioner from acting on information received by it without solicitation, but communicated to it voluntarily by some of its customers, or from advertisements of price-cuttings. This also applies to the objections to paragraph 2 (*b*).

Paragraph 4 only requires the petitioner to desist from "employing its sales agents to assist in such plan by reporting dealers who have failed to observe its resale prices, ... and furnishing said agents the names of customers to whom it has refused further sales because of price-cutting, and instructing them not to sell to such customers." The words "to assist" in such plan must be construed in connection with paragraphs 2 (*a*) and 2 (*b*) "to solicit and secure," and are limited to information solicited and secured from customers, and so forth, the names of customers guilty of price-cutting or, in other words, they must not solicit customers to furnish them with information of those cutting prices of the articles manufactured and sold to the trade by the petitioner, and act on information thus obtained.

It is the cooperative methods in which the petitioner and its distributors and agents act, to prevent price-cutters from obtaining its goods, which it is commanded to desist from. If petitioner's agents are to be permitted to solicit from customers information of those cutting prices and act in cooperation with these customers to ascertain the names of customers who cut prices, the effect would be the same as if the information had been solicited and obtained by petitioner, as it is a corporation and can act only through its agents, whether they are officers or sales agents. The acts of the corporation's agents within their authorized employment are the acts of the corporation.

Construing the orders in these paragraphs as we find they are evidently intended by the Commission, we find them unobjectionable.

The objections on behalf of the petitioner to paragraph 6 of the order are

the practices of the Beech-Nut Company in several other details, but they are hardly of enough significance to warrant specific comment here. In the main the same conclusions apply in this case as were stated in the commentary on the Beech-Nut case.[5]

In its findings of fact the commission took occasion to compare the prices of Cream of Wheat with the wholesale price of purified middlings, apparently to imply that the company was securing exorbitant profits. That comparison was not altogether fair, however, for it did not seem to attach much importance to the company's methods (referred to earlier in the Findings) of selecting the quality, size, and color of middlings for its especial use. The company also incurred some expense for cleaning and packaging its products. Those expenses, as well as other operating expenses, came out of the margins quoted.

The company had stimulated a demand for its product and had secured the confidence of consumers in its maintenance of high standards of material and cleanliness. If it obtained large profits, it is probable that those profits were to be attributed more to the standardization of the product than to the standardization of resale prices.

Any implication that there was danger of monopoly in this case was far-fetched. The company used only 5% of the supply of purified middlings commercially available. The remaining 95% could have been used, if desired, by other breakfast food companies. The com-

that it is too indefinite, not specific enough to enable it to determine what acts may be in violation of that order and subject them to prosecution, when no violation is intended.

It thereupon requested the Commission to add the following proviso to that paragraph:

"*Provided,* however, that nothing herein shall prevent the respondent from performing the following acts:

"(*a*) Requesting its customers not to resell Cream of Wheat at less than a stated minimum price.

"(*b*) Refusing to sell to a customer because he resells below such requested minimum price or because of other reasons.

"(*c*) Announcing in advance its intention thus to refuse.

"(*d*) Informing itself, through its soliciting agents and through publicly circulated advertisements of customers which come to its attention, and through other legitimate means, without any cooperative action with its other customers, or other persons, as to the prices at which Cream of Wheat is being sold."

While paragraph 6 should be construed in connection with the preceding paragraphs as construed by us, by applying Lord Tenterden's Rule of "Ejusdem generis," still in order that there may be no misapprehension on the part of the petitioner as to what is intended by the Commission by the broad language used in this paragraph, we are of the opinion that the requests should have been granted.

Amending paragraph 6 by adding this proviso, the order of the Commission, as thus amended, is
Affirmed.

[5] Federal Trade Commission *v.* Beech-Nut Packing Company, page 489.

pany, to be sure, handled 40% of the business in "packaged cereal foods prepared from purified middlings and sold in the United States by concerns which advertise nationally," but the citation of that figure suggests that a forced effort was being made by the commission to state a figure which sounded large. The company, furthermore, was in competition with many other manufacturers of breakfast foods.

Consumers had a free choice of other brands of breakfast food prepared from purified middlings. They also had a free choice of many other kinds of cereal foods. The volume of business attained by the Cream of Wheat Company, therefore, indicated the satisfaction of consumers, not their exploitation. They paid the standard resale prices willingly. Hence any implied criticism of the company's margin of profit signified a desire on the part of the commission to effect sumptuary regulations which are neither desirable nor legal.

June, 1926 M. T. C.

Federal Trade Commission *v.* Toledo Pipe Threading Machine Company[1]

MANUFACTURER—PIPE THREADING TOOLS

Price Maintenance—*Standardization of Resale Prices by Cooperative Means Held Illegal.* The company, which manufactured pipe threading, boring, and cutting tools, and similar products, sold its goods to wholesalers for resale to users. The company specified resale prices and sought and obtained the cooperation of its wholesale distributors in maintaining those prices. The Federal Trade Commission ordered the company to discontinue: obtaining assurances from wholesalers that they would maintain the standard prices; encouraging wholesalers to report price-cutters; employing its salesmen to investigate charges of price-cutting.[2]

(1925)

COMPLAINT

Acting in the public interest pursuant to the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes," the Federal Trade Commission charges that the Toledo Pipe Threading Machine Company, hereinafter referred to as respondent, has been and is using unfair methods of competition in interstate commerce, in violation of the provisions of Section 5 of said Act . . . .

. . . .

Par. 4. The acts and practices of respondent set forth in the preceding paragraphs have had and still have the tendency to constrain and do constrain all jobbers and other distributors handling respondent's said products to sell the same at the said resale prices fixed and established by respondent and to prevent such distributors from selling said products at such lower prices as they might deem to be adequate and warranted by their respective selling costs and by trade conditions generally, and hence to hinder and suppress all competition in the resale of such products, thus tending to obstruct the free and natural flow of commerce therein, and the freedom of competition in the channels of interstate trade.

. . . .

FINDINGS AS TO THE FACTS

Paragraph 1. Respondent, Toledo Pipe Threading Machine Company, is now and since 1902 has been a corporation organized and existing under and by virtue of the laws of the state of Ohio. Its principal

[1] Federal Trade Commission, Docket 1018, January 13, 1925.

[2] Headnote by Graduate School of Business Administration.

office and factory is at Toledo, Ohio, where respondent has been since its incorporation and is now, engaged in the business of manufacturing pipe threading, boring and cutting tools, and other similar products, all of which it has sold and continues to sell to dealers located at various points in all of the states of the United States, and to some extent, in foreign countries. The respondent transports or causes to be transported its products when sold, from its factory at Toledo, Ohio, to the purchasers thereof at their various locations throughout the United States and to foreign countries.

In the course and conduct of its business respondent is in competition with other individuals, partnerships and corporations, such as Oster Manufacturing Company, Cleveland, Ohio; Hart Manufacturing Company, Cleveland, Ohio; The Borden Company, Warren, Ohio; Greenfield Tap and Die Corporation, Greenfield, Massachusetts; and The Nye Company, Chicago, Illinois. These competing corporations are engaged in the manufacture of similar devices or devices for performing the same character of work, and sell and transport the same from their respective factories into and through the various states of the United States.

Par. 2. Respondent's products as a general rule, are sold to the consumer at prices lower than those charged for similar devices by its competitors. They have a good reputation, are regarded as among the best in their class, and are in constant demand. They are used generally by skilled laborers such as plumbers, steam and gas fitters, and other similar workmen employed in assembling pipe and pipe fittings. Respondent's annual sales exceed one million dollars in amount.

Par. 3. In an official communication to the Commission the respondent stated its selling policy as follows:

> From the very inception of our business some twenty years ago, three fundamental lines of action were determined upon: First, the establishing of definite prices for our products to the consumer; second, to market the product through the well-established jobbers and dealers of the country; third, to see to it that the jobbers and dealers uniformly used the prices established by us for the consumer. The organizers of the business were men of mature experience and the policy above outlined was decided upon because a reasonable price effective to all alike, in any given community, was equitable; and the widest possible distribution could be obtained at the least sales or overhead expense by utilizing the well-established dealer organizations of the country. Then, at the very beginning of our career, we employed missionary salesmen to travel over the country and introduce the tools to prospective users thereof. This was followed by trade journal and other more direct advertising methods. The names of prospective purchasers thus obtained, and orders from actual purchasers, were turned over to jobbers and dealers in the different communities

> as the nucleus of the larger business to come. A percentage of the price of each tool was named as the compensation of the jobber and dealer for the service he was to perform, namely, that of carrying our tools in stock; distributing same to the consumer; paying for same often before they were resold; and eventually supplying the demands of consumers of all sorts and descriptions in his locality. Always pursuing the same policy the business has grown until there are now approximately about twelve hundred dealers in the United States carrying our tools in stock, subject to the demand of the ultimate consumer. It has been our job to constantly widen the sources of supply and to keep those sources actively interested along the lines laid down by ourselves, so that the public would be satisfied. In our experience have been included requests for exclusive agency arrangements; limiting our distribution to one jobber in a community; suggestions that we increase the selling price abnormally; and demands for larger percentages of profit for the dealer. To such requests and demands we have always turned a deaf ear. We still are pursuing the policy of fixing a reasonable price for the consumer, and a reasonable percentage beyond this for the distributor, and are insisting that the distributor shall maintain these prices.

As indicated in this statement, the respondent sells its products to dealers who in most cases are dealers in other products, as well as competitive devices, who sell at retail to the consumers or users of such devices. The respondent also sells direct to any consumers who apply for the privilege of purchasing direct from the manufacturer. But the prices charged such direct purchasers are the same as would be charged by a dealer so that the direct purchaser obtains no financial benefit from this method of purchase.

Par. 4. The respondent issues periodically to its dealers, price-lists or statements which are more accurately described as "discount sheets." These discount sheets contain a list of the products, their weights, and a base list price for each. In addition to the list price the discount sheet states with reference to each item a jobbers' discount, which varies between jobbers who regularly carry a specified stock and jobbers who do not carry a specified stock. The price to the jobber is determined with reference to any item by applying the discount rate to the list price and deducting the percentage of the list price determined by the discount rate. The discount sheet also contains what are denominated as "resale discounts," of which there are two classes, one applicable to resales made in certain specified territory which may be generally identified as the western territory, and the rates effective in the remainder, or eastern portions of the country. The price to the consumer which the dealer is expected to apply in accordance with the discount sheet is determined in the same way that the jobber's discount is ascertained, by the application of the applicable resale discounts. The respondent issues the discount sheet in this form for the reason

that the prices of its products both to jobbers and consumers vary more or less frequently, and if instead of a base list price with discount stated, the respondent should attempt to issue lists with the discounts calculated and stated in the form of prices, the trouble and expense of rearranging its lists would be very great. It is the practice of the respondent as well as of its dealers, to issue catalogs which are rather elaborate and expensive, sometimes illustrated, and each edition of this catalog would be rendered worthless by a price change. By quoting prices on the basis of certain discounts from a base list, a price change can be put into effect by the issue of a simple and inexpensive discount sheet. These discount sheets issued by the respondent to its dealers from time to time are communicated to its dealers and the information transmitted by the dealers to the salesmen.

There is no evidence that the prices to the consumer, fixed by the respondent, are unduly high, or that the spread between the price fixed by the respondent to the dealer and the price fixed at which the dealer is expected to resell to the consumer, is unduly large. On the other hand, it appears that the devices of the respondent in general sell at lower prices than similar devices of its competitors, and the spread allowed by the respondent to its dealers is lower than that allowed by the competitors of respondent to their dealers.

Par. 5. Respondent's prices are f.o.b. Toledo, Ohio, net 30 days or 2% for payment within 10 days from the date of invoice. Certain other allowances are made upon terms and conditions definitely stated on the discount sheets.

Par. 6. The respondent publishes a resale discount effective in territory east of Montana, Wyoming, Colorado, and New Mexico, and Pecos River in Texas; and a slightly higher resale discount for the territory west of that line. Some time during the recent war due to changes in freight rates, the respondent made an effort to establish the Mississippi River as a dividing line because in addition to the jobber discounts respondent makes a maximum freight allowance and at that time the freight charges from Toledo reached the maximum allowance approximately at the Mississippi River. The reason for the division of territory is stated as follows:

> Our jobbers' prices carry the same discount in the eastern and western territory. The jobber in the west not only has to pay the excess freight but he has to carry by reason of his long distance from Toledo, an investment in two stocks, one on the road and one on his shelves. Therefore he is entitled to a larger differential to enable him to carry the existing increased expense of doing business.

The jobber in the western territory pays the difference between the actual freight and the allowance made by the respondent, and it is to take care of the extra expense in the western territory that the

margin to the jobber is increased by raising the resale discount in that territory.

Par. 7. According to exhibit number six,[3] the Mississippi River was adopted as the boundary line between these two discount territories on March 10, 1920. And this division remained effective until the issue of the discount sheet of January 1, 1922. (Exhibit No. 8).[3] The adoption of the Mississippi River boundary was announced by the respondent to its dealers in a bulletin dated March 10, 1920, as follows:

> Owing to radical increase in labor costs as well as the prices of raw material, it is absolutely necessary for us to increase the price of the Toledo No. 00 ratchet threading device, and the Toledo No. 0 adjustable threading device. The same necessary increase in price applies to all repair parts including extra dies for these two tools. . . . . Please note that the suggested resale or consumers' discount is five points higher west of the Mississippi River than the consumers' price east thereof. Heretofore this difference in resale prices applied in the territory west of the eastern boundary of Montana, Wyoming, Colorado, and New Mexico, but increased transportation costs have moved the line at which our maximum freight allowance does not cover the actual freight cost, several hundred miles farther east. Hence it seems wise to us to support the jobbers in the mid-western states by this suggested preferential in resale discounts. This will also apply to all other tools made by us.

Par. 8. On March 27, 1920, the respondent issued a supplemental bulletin to its jobbers transmitting its new discount sheet (Exhibit 7)[3] at the conclusion of which it was stated:

> If these announcements and the data set out on the discount sheet are not perfectly clear to you, kindly write us for further information. Thanking you for your cooperation and trusting to merit a continuance of your favor, we remain, and so forth.

On December 27, 1921, respondent issued a bulletin to jobbers transmitting the discount sheet effective January 1, 1922 (Exhibit 8).[3] This bulletin stated in part:

> The attention of jobbers south of Virginia and Kentucky and as far west as the eastern boundary of Colorado is also directed to the fact that we have abandoned our previous effort to establish a higher resale schedule in their territory. This differential had seemed justifiable to us but owing to the overlapping into that territory of jobbers east and north thereof whose published price lists carried the lower scale of discounts, it is impossible of uniform accomplishment. Jobbers are therefore asked to note carefully the boundary line at present established as applying to the eastern scale of prices and the western scale of prices.

[3] Exhibits not published herein.

The treasurer of the respondent testified that as a result of moving the line east to the Mississippi

> . . . . we ran into such a smear of jobbers east and west of the line that were trying to take advantage of the eastern prices as against the western prices that we found our position was untenable so we moved it back to the original line.

This complication arose by reason of complaints made to the respondent by jobbers that other jobbers were not maintaining the established resale discount for the territory in which the sale was made. A reduction of freight rates at about the time of the issue of the discount sheet of January 1, 1922, assisted in the desired readjustment.

In a communication addressed by the respondent under date of November 4, 1921, to the N. O. Nelson Manufacturing Company, St. Louis, Missouri, the respondent stated in part:

> A year or so ago by reason of advance in freight costs it was suggested to us that we move the western territory in so far as our product was concerned, east as far as the Mississippi River, which we accordingly did. We are frank to confess that that move has been more or less unsatisfactory because St. Paul, Chicago, and St. Louis jobbers did not uniformly adopt the western schedule for the territory lying immediately west of the Mississippi River. Now our idea in promulgating a resale price and endeavoring to have it used uniformly by all jobbers in any given territory, is obviously because we want the jobbers selling our tools to have a reasonable margin of profit thereon, and we want to adopt a policy that all jobbers at interest are most likely to be in accord with. In view of your opinion as expressed to our respresentative, will you not kindly write us a letter setting forth your ideas as to the boundary lines in the United States that should divide the territory in which the eastern and western schedules should apply? We are asking for this suggestion from you because of your location in the territory involved, and will greatly appreciate your advice on this subject.

The Nelson Manufacturing Company replied, stating that:

> There are other jobbers who issue price sheets east of the Mississippi and are also distributed west of the Mississippi using the same price such as Standard Sanitary Manufacturing Company, Chicago and St. Louis branches. It would seem to us inasmuch as most all of the jobbers in the immediate Mississippi Valley especially Chicago and St. Louis are soliciting business west of the river, that they would be on the same basis as regard to quoting the trade. Very few if any, go west of the Kansas line and it would seem to the writer this is a more favorable division point because none of the jobbers overlap so much at that point, that

is we mean eastern Colorado state line. This we believe would eliminate possible interference and dissatisfaction with the trade who buy in Kansas City, Chicago, and St. Louis.

The respondent sought the advice of the Nelson Company whether the dividing line should be carried from the Mexican border to Canada running straight north and south through the eastern boundary of Colorado, to which the Nelson Company replied that:

> You could make the division through the United States the eastern line of Colorado, that is continuing the same south from this line because we believe you will find very few central state line jobbers working west of this line.

Par. 9. An incident of the confusion arising out of the application of the eastern territory resale discount in the western territory, appears from correspondence between the respondent and the H. Channon Company. The latter, a dealer in Chicago, made a sale of a threading device at Burlington, Iowa, at 50% off the list, f.o.b. Chicago. This was reported to the respondent who evidently, though the letter is not in the file, took the Channon Company to task for this quotation. To which the Channon Company replied on September 16, 1921 (Exhibit 22)[4] admitting the quotation should have been 45% off list instead of 50%. The respondent replied under date of September 21, 1921, stating in part:

> It may be possible that the eastern and western territorial dividing line as established by us is not a logical one, but we very much wish that in your quotations you adhere to our published schedule in this respect until such time as it can be more definitely verified or changed to make same equitable.

It subsequently appeared that the questioned quotation was correct because of the fact that Burlington, Iowa, lies on the Mississippi River.

Par. 10. It is to be noted that the respondent objected to the introduction in evidence of the documents relating to the variation of the boundary line and the confusion which arose therefrom, alleging that this was a closed incident which had no relation to the issues raised by the complaint. The objection does not seem to be well founded because these documents reveal clearly the policy of the company with reference to resale price maintenance and form a part of the history of this practice on the part of the respondent. It tends to show also the degree of cooperation between itself and its dealers which the respondent sought to establish, not only in the maintenance of the resale discounts but in the location of a division of territory which would remove so far as possible, the likelihood of the lower discount rates of the eastern territory being used to the disadvantage of jobbers in the western territory. Since it is the duty of the Commission to

[4] Exhibits not published herein.

ascertain all pertinent facts with relation to a given practice, the objection was based upon a misconception of the proceedings and was properly overruled.

Prior to the issue of the discount sheet of March 10, 1920, by which the Mississippi River boundary line was established, the W. J. Baird Machinery Company, of Detroit, Michigan, under date of July 8, 1919, filed with the respondent an order for certain tools, upon which order blank was printed the customary terms of the Baird Company, namely, 2% tenth to fifteenth of month following shipment, or 60 days net. This invoice in the files of the respondent is marked "Don't ship," the mark being placed there by the treasurer of the respondent. Receipt of this order was acknowledged by the respondent and the attention of the Baird Company was called to the discrepancy in the terms of sale. The Baird Company corrected its order to correspond with the respondent's requirements. The documentary evidence in connection with this incident is not complete, but it is apparent from a letter written by the Baird Company to the respondent on the same date, that the respondent, under date of July 9, had called into question price quotations made by the Baird Company to the Ford Motor Company. The Baird Company responded to this communication on July 10, stating that its deviation from the list price was made necessary by a competitive quotation from another jobber. The concluding paragraph of the Baird letter is:

> We have your schedule of prices in our possession but had no strict instructions that said prices were to be maintained, and accordingly cut. We assure you it is not our policy to slash prices at any time unless we are confronted with the conditions above noted. We certainly desire to sell Toledo tools as they afford our customers good satisfaction, and trust that the course followed meets with your approval. We would like to hear from you regarding the above, and remain, and so forth.

The respondent replied to this communication as follows:

> We acknowledge your letter of July 10, and note with regret that you have seen fit to depart from our published resale prices in quoting the Ford Motor Company. Under these conditions we have filed your order 12259 marking same canceled, as we will not be able to ship further goods for your account.

To this communication the Baird Company replied on July 16 offering as explanation that the questioned quotation was against the policy and principle of the Baird Company, placing the responsibility upon a salesman acting without authority, and stating that had the writer known of the matter the order would have been returned to the Ford Company regardless of the loss of business. This letter concluded:

> In conclusion, all I can say is "kindly reconsider the matter." Assuring you that the writer personally as well as our entire organ-

ization heartily upholds your policy and will work with you in every possible manner in order to prove to you that we are worthy of your confidence.

Par. 11. The treasurer of the company interrogated with reference to this "don't ship" endorsement stated that the information upon which such action would be taken was usually obtained through the statement of some other jobber who wrote the respondent about an order being placed at less than the resale discount. This complaint the respondent usually investigated by writing the jobber alleged to have done the price-cutting. If the report was found to be true the order of the jobber found to be departing from the resale discount was rejected. And further business relations with him were suspended unless it developed that the questioned quotation was purely an error, a matter of mistake on the part of the jobber at fault. He said:

> It is only the flagrant violations of our confidence with the individual who blatantly insists that he makes his own prices and does as he pleases, that we cease doing business with.

Par. 12. Subsequently to the establishment of the Mississippi River boundary and while that dividing line remained, one of the dealers of the respondent at Milwaukee, Wisconsin, wrote the respondent on July 23, 1921, stating that it had made a quotation to a prospective purchaser at Kenosha, Wisconsin, in accordance with the established resale price applicable in that territory. It appeared that the prospective purchaser had secured quotations from six jobbers and as the respondent was informed by this dealer, two of the six quotations were considerably better than the established resale price. The letter continues:

> We are giving you this information in strict confidence because our representative has been instructed to ascertain just what price was quoted by one of the other jobbers and advise Mr. Blank that we would meet the price, providing the name of the jobber was given us. We are giving you this information to forestall any information which may be entered by one of the other jobbers, accusing us of cutting prices. We thought possibly you would have some means of ascertaining the names of the six jobbers referred to above. At any rate we would not want you to make use of our name in this connection.

This communication was acknowledged by the respondent on July 26 as follows:

> We are in receipt of your letter of July 22 with reference to the various quotations received by Mr. Blank of Kenosha, Wisconsin, on a Toledo power drive. We do not see how any jobber can afford to quote one of these drives at less than 50%, f.o.b. his stock, and we would very much like to know what jobber it is that is alleged to have made such a price. Certainly it is not conducive to price maintenance for you to agree to meet an alleged lower

price. Please keep us informed if any further details come to your knowledge.

Par. 13. Again in another part of the selling territory a like situation arose. On January 25, 1921, the respondent wrote the Axtel Company, Fort Worth, Texas, stating that the respondent was in receipt of advice that the Axtel Company had been quoting a discount of 40% and 5% from list price, whereas the discount applicable in that territory should be 35%. The respondent stated:

> This information is not very definite in that it does not tell us to whom these quotations have been made or on what size of our tools that quotation has been made. But we think it wise, nevertheless, to call your attention to the matter in order that you may investigate. We should be glad to have you investigate and let us know what the facts are.

Apparently no reply was received to this communication, and on February 23, the respondent wrote again stating that they had received further information as to the purchaser to whom the questioned quotation had been made. The letter concluded:

> You buy Number 1 and Number 1-A tools at a discount of 40%-20% and we submit you cannot afford to sell them at 40%-5%, or anywhere near that price. The proper quotation covering these tools in your territory ought to be a discount of 35% from list. Will you please investigate the quotation made by you to the two parties named, and let us know if our information is correct. We shall be very glad to have a word of advice from you as to what your future policy in this connection would be.

The Axtel Company replied on March 15, admitting the quotations in question and justifying them upon the necessity of meeting competitive prices, and indicating that under similar circumstances the resale discounts would be cut if necessary. To this the respondent replied as follows:

> We duly received your letter of March 15, containing the information that you had quoted a discount of 40%-5% on Number 1 and Number 1-A Toledo tools. Needless to say, you cannot sell these tools at any such price and make any money. Since the receipt of this information there has been nothing shipped for your account, but as there are some orders which are now in line we should like to be assured that our suggested resale schedule will be maintained. . . . . Trusting that we may have your full cooperation in this respect, we are, and so forth.

The Axtel Company replied that it always made a special 5% discount to old customers who bought all their supplies from the Axtel Company, and this they proposed to do whether they ever sold Toledo goods again or not. The respondent replied that:

We are sorry to advise that we cannot do business with you on any basis.

There was some subsequent correspondence with reference to a resumption of business relations running through the latter part of 1921, and the respondent on January 24, 1922, acknowledging the receipt of an order from the Axtel Company, said:

> We would like to accept this business and put your account back again on to our ledger, but as the matter now stands we are not willing to do so. If your executives are willing to assure us that tools of our make will be resold at our published resale schedule and no other prices, we will be willing to take the matter under advisement.

The Axtel Company endeavored to obtain acceptance of its order without giving the required assurance. The respondent reiterated its position on February 7, stating:

> While we highly value your order and would like to fill it, we cannot do so except you are willing to subscribe to our resale policy. . . . . Now, unless you want to mend your ways and assure us over the signature of a qualified official of your company that it is your intention to absolutely observe our price policy, we care to have no further correspondence or dealings of any nature with you. As we have before stated, our very existence depends on our taking and maintaining this position. If, however, you are now disposed to modify your line of action as outlined to us in your previous correspondence, we will be glad to hear from you further and give you such consideration as you are entitled to.

The Axtel Company questioned the legality of giving such assurances. Examination of the treasurer of the company who was in effect its sales manager, upon the documentary evidence with relation to the Axtel Company, resulted in the following disclosure of the respondent's policy:

Q. Did you ever resume business relations with Axtel and Company?

A. No, sir.

Q. You sometimes do resume business relations with people with whom you have discontinued, don't you?

A. Yes.

Q. Under what circumstances?

A. A reasonable indication that they expect to sell our goods at the proper price.

Q. Well, how do you get such reasonable indications, from personal interviews, or correspondence, or both?

A. From correspondence.

Q. Then in every case where you resume business relations

with the parties you have dropped for price-cutting you have some letter from the party that leads you to the reasonable belief that they will maintain your resale price?

A. I believe that can be stated without exception.

Q. And if you received a letter from a man with whom you have discontinued selling for the reason that he was not maintaining prices, which offered a resumption of business but was evasive and equivocal, you would turn him down, wouldn't you?

A. Very probably.

Q. The fact of the matter is the letter would have to amount to a promise to maintain your resale price, wouldn't it?

A. Yes.

Par. 14. In April, 1922, the representative of the respondent at its New York office inquired of the home office whether prices had been quoted to a prospective purchaser in Philadelphia. The New York representative in his memorandum stated:

> If so, will you make a note to cut them out, as Mr. Blank showed me where they had made a quotation of 10% lower than our best price to a user, although they quoted f.o.b. factory. The Fairbanks Company also sent out a quotation of 5% better than our resale price. I went into this again very thoroughly with Mr. Pierson, manager of the Fairbanks Company, and their man who made the quotation, and I do not believe that we will have any further complaint about the Fairbanks Company.

The home office of the respondent informed its New York representative that sales had been made to the Philadelphia purchaser, and concluded:

> There was no excuse for its not having adhered to our resale schedule because we have called attention to our mandatory price. We will get the account paid up as rapidly as possible and will then cease having any further relations with it.

To the dealer in question the respondent wrote stating that a report had come to it that the dealer had quoted beyond the resale schedule, and stated:

> We have at various times particularly pointed out to you our mandatory resale prices, so that there was no excuse for your quoting any other price. We must ask that you take immediate steps to correct any such quotation that may have been made by you, acknowledging at once the receipt of this letter.

The Philadelphia dealer replied, stating that it was unable to locate the questioned quotation and asking whether the respondent could give it the name of the customer to whom the questioned quotations were reported to have been made, so that identification could be made of the salesman who was responsible therefor, and concluded:

> It is not our policy and never has been our policy to sell at cut price. We are not a cut-price house and will not tolerate our salesmen doing business this way. Any cooperation you can give us in the way of advising where this has been quoted, will be kept strictly confidential and greatly appreciated.

There was some argumentative correspondence back and forth which resulted finally in a refusal to sell this dealer both for the failure to maintain the resale prices and for neglect to pay bills within the terms of sale. To its New York manager, however, the respondent stated with reference to the disposition of this dealer's account:

> The best way to handle this matter will be to file all the correspondence and close the account as soon as we receive settlement for its present indebtedness to us. We will not ship it any more of our tools.

Par. 15. On May 18, 1922, one of the respondent's dealers wrote protesting the operations of an alleged price-cutter. To which the respondent replied:

> We then wrote a letter stating that if the present company was in a position to purchase our product in quantities and would assure us that it would under all circumstances maintain our retail schedule, we would accept business from it as a dealer.

The original of this letter does not appear in evidence. Apparently the respondent wrote the dealer in question on the subject of resale price maintenance because the record shows a letter from this dealer to the respondent assuring the respondent that there were almost daily reports that the standard quotations were too high, indicating that some one in the territory was violating the resale discounts, and stating:

> When we can get the definite source of the reason for such comments we shall present the case to you in a way that we can substantiate with more than mere assertion. . . . . We shall be pleased to cooperate with you in any way possible to determine the real truth of this matter. Thanking you for bringing this subject to our attention in the perfectly frank way you did, and again assuring you of our absolute loyalty, we remain . . . .

To which the respondent replied:

> We acknowledge your letter of May 20 and thank you for same. We will be glad to have you keep us informed along the lines suggested for our mutual benefit.

Par. 16. Respondent did not always confine its efforts in resale price maintenance to correspondence or interviews with single jobbers. On certain occasions it adopted the method of circularizing all the dealers in the affected territory, and endeavored to exact from each an assurance of rigid adherence to the applicable resale discounts. Toward

the end of the period in which the Mississippi River was the dividing line—namely, July 26, 1921—respondent issued a circular addressed "To Jobbers Quoting and Selling the Trade West of the Mississippi River," calling attention to the fact that the resale discounts applicable to points on the river and east, did not apply to points west of the river, and advising all jobbers that it had been informed that certain jobbers east of the river were quoting consumers west at the eastern scale of prices. The circular continued:

> Jobbers having followed the above practice are asked to withdraw such quotations at once and covering all quotations or sales in the territory west of the Mississippi River, use our western resale schedule and make their quotation f.o.b. shipping point, but with freight equalized with nearest point where there is a jobber carrying our tools in stock. Please acknowledge receipt of this bulletin indicating your understanding and willingness to cooperate.

A duplicate of this bulletin dated July 30 was also issued for reasons which are not explained. This bulletin was sent out to all jobbers to whom it applied. The respondent objected to the introduction of these exhibits and to other matters relating to them, arguing that it was a dead issue in which the Commission could have no interest. For the reason previously stated it seems that the objection was properly overruled and the exhibits and evidence properly admitted. A number of replies were received in response to the request for an acknowledgment of the receipt of this bulletin and an indication of the understanding and willingness of the jobbers to cooperate. Some of these were simple statements of acknowledgment of receipt; others were assurances of observances of the suggested prices at all times; others stated that the writers would be "governed accordingly." Others stated, "We shall be pleased to maintain the retail schedule as requested." Another stated, "You may be assured we will cooperate with you in this matter."

Par. 17. Apparently the replies received were not sufficient to satisfy the desires of the respondent because the bulletin was reissued with an addition at the top reading as follows:

> The original of this circular was sent to you on July 30. We have not received a response. Kindly let us hear from you at once because we desire to have unanimous action on the part of all jobbers interested.

This was sent to all jobbers who had not responded to the original circular. This produced results in a number of cases. One dealer said, "Care is being taken to comply with the above requirement." Another, "Will govern ourselves accordingly." Another stated, "Will be very glad to cooperate on this basis." Another, "We most certainly will comply with your request as we are hardly [*sic*] in favor of such plan." Another said, "We assure you of our willingness at all

times to cooperate with you in this respect." Another, "We assure you that prices will be quoted in accordance with your request." To one jobber who made no response to either the first or the second circular the respondent wrote, attaching a copy of the bulletin and stating:

> Practically every other jobber in the territory at interest, as far east as Chicago, has written us expressing approval of this price schedule and agreeing to maintain it in quoting west of the river. We want and must have the cooperation of your organization in this direction if this western schedule is actually to be made effective.

This particular dealer replied that on legal advice he made no agreements with any one relative to resale prices and, therefore, was unable to accept the circular letter referred to. This dealer, however, while he refrained from giving the assurance called for, in the following December reported that St. Louis jobbers were selling tools at the eastern resale discount price and advising that the Wichita branch of this respondent in order to obtain business would be obliged to meet this competition. To this the respondent replied stating that its Mississippi River boundary line had not proved satisfactory, "Although we have written many letters and have taken the matter up personally on some occasions. We have finally concluded that that boundary line is too arbitrary to be effective."

Par. 18. The respondent applied the method of general circularization of its dealers in territory in which variations of the resale discount were reported, as the occasion seemed to warrant. A circular letter in the following form was sent to all of the jobbers in the Pittsburgh territory on or about May 15, 1922:

> Gentlemen: It has been reported to us that two jobbers in your community have recently and very foolishly quoted on Toledo tools at a most decided reduction beyond the resale schedule. Our established price to the consumer is reasonable and the margin of profit provided for the jobber who sells our tools is likewise reasonable; there is absolutely no reason why our resale schedule should not be maintained without deviation at all times. We attach hereto a copy of our resale sheet which contains the list prices and the discount applying thereto. We will appreciate your close cooperation in the absolute maintenance of this schedule and would like an expression from you if you care to give it. We have only one recourse for the jobber or dealer who will not maintain our resale schedule, and that is to cease selling that jobber or dealer.

The purpose of issuing this circular letter was, as stated by the treasurer of the respondent, "to curtail any proclivity that may exist on the part of jobbers who had not offended, to meet the prices made by offending jobbers."

The replies to this Pittsburgh circular are not all in evidence. But the treasurer of the respondent stated that while he had no particular

recollection, he would say that answers were received generally to all of these letters. In further explanation it was stated that this circular would encourage a dealer who wanted to make a reasonable profit and was bothered by claims of lower prices quoted elsewhere, because he would realize that the respondent was endeavoring to create the impression that a stable line of prices would be supported by the respondent. One of the dealers in Pittsburgh to whom this circular went stated that it was adhering to the suggested resale price but was losing business as a result. To which the respondent replied as follows:

> We must do all we can to insure the stability of prices in our line in any community where some dealer is foolish enough to inaugurate a destructive price-cutting campaign, and this was the reason for our letter of the 15th. We believe we have the matter well in hand and hope the tendency to get away from our resale schedule is definitely checked.

One of the Pittsburgh dealers apparently was written a special letter making direct charges of violation of the resale discounts, and arguing the necessity for adherence thereto. The letter concluded:

> Our only recourse in matters of this kind is to cease selling the jobber or dealer who will not maintain our resale schedule. We therefore suggest that you investigate this matter thoroughly and let us have a detailed response setting forth all the facts as you can find them, and advising us what we may expect relative to your policy in future. Your immediate attention will greatly oblige. . . . .

The dealer in question replied with considerable explanation and concluded:

> You may take this as our assurance that your established resale discount of 50% will be absolutely maintained by us in future, and if our competitors are inclined to cut your prices, that would be a matter strictly between themselves and you. This company will, in future, maintain your established prices to the letter.

The effect of the Pittsburgh circular was stated by the respondent in a letter of May 25, 1922:

> I am glad to tell you that the responses received have, in the main, indicated a strict adherence to our resale schedule. Before the matter is dropped we will have everybody in line, although it looks as though we will have to cease selling one of our connections who has not, up to the present moment, replied to our letter. It is that particular dealer who has been reported to us as "running wild" with his quotations.

It is in evidence that the particular dealer referred to finally made a satisfactory reply which resulted in assurances of resale price mainte-

nance being made by all of the Pittsburgh dealers. And there was no further complaint from that territory.

Par. 19. The California National Supply Company on November 5, 1921, complained to the respondent that its resale prices were not being maintained and that it was unable to trace the shipments of local jobbers who were varying from the resale discount. To which the respondent replied, acknowledging the receipt of this communication, regretting that the identity of the price-cutters could not be obtained, and stating:

> Under the circumstances we cannot do anything that will be very effective, but we will write a letter to each one of the Los Angeles jobbers, sending them a copy of our resale discount sheet, and ask them all to adhere strictly to this schedule. We attach hereto a copy of the letter we will send out. We hope this will accomplish the desired result, but in the meantime, suppose you have your sales force keep their eyes and ears open, and perhaps they will locate the people who are doing the price-cutting.

The letter referred to, after stating the report of price-cutting and arguing in favor of its maintenance from the point of view of the interest of the jobber, concludes:

> May we ask that you go into this matter fully and let us have your response as soon as you have a comprehensive knowledge of the situation.

This letter went to all of the jobbers in Los Angeles and replies were received from some of them, whether from all of them the witness was unable to state. There were no further complaints of price-cutting after the issue of this letter. A number of replies stated, "Assuring you that it is our desire to cooperate with you at all times;" "We have always respected your wishes with regard to the retail price of your goods;" "We are adhering to the suggested discounts without variation;" another stated, "We will do everything possible to maintain these retail prices and if we can furnish you any information at any time regarding any one cutting these prices, you may be assured we will cheerfully do so." One of the Los Angeles dealers, upon receipt of this letter, called the attention of the respondent to the fact that previous complaint had been made concerning sales made by the respondent to an oil well supply company, to which the respondent replied:

> We are pleased to advise that our files show that at that time we went into this matter exhaustively with the Lacey Company, which admitted having made quotation as charged. . . . . At that time they expressed their regret at having made the quotation which they contended was really a clerical error, and promised that there would be no recurrence of like nature. With this unequivocal promise we have continued to sell the Lacey Company. Should there be any later evidence that they have not been adhering to

our retail schedule we hope you will not fail to advise us regarding it.

Par. 20. The Standard Supply and Equipment Company of Pittsburgh, Pennsylvania, was reported to the respondent as having departed from the resale discount. The respondent wrote on May 23, 1922, and the Standard Supply Company replied on June 6, admitting and justifying the cut. The respondent inquired for further details, advising that the Supply Company's order was being held meanwhile. Apparently an adjustment was reached satisfactory to the respondent. The writer said:

> Since this matter has been adjusted to your satisfaction we have been very careful to quote nothing lower than discount you suggest. . . . . We shall be very glad to assist you in helping to right matters for you in Pittsburgh.

The respondent acknowledged this letter, stating:

> We will report to you later if we have anything definite in this case.

The Supply Company placed some orders subsequently which drew from the respondent an inquiry dated June 7, 1922, whether the tools were actually sold at the prices stated and, if not, at what prices they were sold, and also inquiring whether the orders originated with the Pittsburgh house. The Supply Company advised in reply that the orders originated in Philadelphia and that the regular resale prices should have been maintained. The respondent queried in response, "Will you kindly tell us if our regular resale prices were secured by you covering the material specified on these orders." The Supply Company wrote that the business was secured at the regular resale prices.

Par. 21. In November, 1921, the W. D. Allen Manufacturing Company, of Chicago, called the attention of the respondent to the cutting of the resale discounts in Chicago, stating that "There are two concerns in Chicago that the writer knows do not hold to the resale price." The respondent replied, stating that they could do nothing unless the Allen Company would furnish the names of the jobbers responsible for the variation, saying:

> In our mutual interest you ought to do this. We would protect your name and keep you out of it. But we would like to get after any jobber who is cutting the prices on our product because we consider this price-cutting to be a stab at our very life's blood. The only way we can be sure to maintain the interest of the jobber in our product, is to make our tools profitable for him to sell, and the fellow who breaks down our resale schedule is operating against us. Therefore, we trust you will let us have all the information you have at your command in this direction.

Par. 22. The information afforded by this letter was the basis of a general circularization of all Chicago jobbers by bulletin issued April

19, 1922. This bulletin states that one of the respondent's salesmen, Mr. Thornberry, had been in Chicago and reported a very unsatisfactory state of affairs with reference to the sale of the respondent's products. After presenting argument in favor of its policy of resale-price maintenance and the protection afforded thereby to the dealers in respondent's products, this bulletin concluded:

> Now we propose, if it is at all possible, to see that our resale schedules are maintained. The Toledo factory is running full time and is busy, and if we have to we can well get along without Chicago business. We are going to sell our tools to the jobbers who do maintain our prices, who will get a reasonable margin of profit on which to do business. May we not have your cooperation? We want a real show-down in this matter with all the cards on the table. Trusting that we may have a full a [*sic*] complete reply by return mail, we are, and so forth.

While dated in 1922 this bulletin was evidently issued in 1921. A considerable number of replies were received by the respondent to this bulletin. One jobber stated, "We ourselves have never sold any Toledo tools at anything different from your sheet." Another stated, "You can absolutely depend upon us not to make any rebates or cut prices in our territory. . . . . However, you can be assured that except through an error or mistake you will not have occasion to complain about us, and our books will be open should it become necessary." To one of the jobbers, the respondent wrote with reference to the bulletin in question:

> We feel quite sure that the jobbers in Chicago and elsewhere will not sell any more Toledo tools by cutting the price, and they will get just as much business by adhering to our resale schedule. What we are trying to develop by this bulletin we sent out is some exact fact or facts as to who is doing this price-cutting, because then we believe we will be in shape to stop it.

Another jobber said, "We understand that you insist upon this policy and have endeavored to religiously follow it." Another stated, "We have never cut the price, as the margin now derived, based upon last year's cost of doing business, does not reflect any profit on these goods."

Par. 23. In June, 1922, departure from the resale discounts in Baltimore, Maryland, came to the attention of the respondent, resulting in a form letter sent to all the jobbers in Baltimore. This form letter states:

> We are addressing this letter simultaneously to all the jobbers and dealers in Baltimore that sell our tools. Two jobbers have reported to us that somebody is cutting the prices on Toledo tools 5% or more. One of these jobbers used the expression, "Lots of them are doing it."

After arguing in justification of its policy and the reasonableness of its margins, the respondent in this form letter stated:

> Our only recourse in a matter of this sort is to cease selling the jobber who will not maintain our published resale schedule, a copy of which we attach hereto. Will you please let us have an expression from you as to your attitude in this matter. You will thus greatly oblige.

A number of replies were received by the respondent from Baltimore dealers in response to this form letter. One stated, "We have been and intend to strictly adhere to the new discount sheet." Another said, "We have at all times maintained your regular resale prices." Another, "We have steadfastly maintained your resale schedule though we frequently lose orders by so doing. We will heartily appreciate any steps you take to induce all your dealers to maintain this schedule." Another said, "We are more than glad to cooperate with any manufacturer on a suggested resale price basis because we are in the business to make a profit." Another wrote, "We will positively adhere to your selling price and will report to you if we are able to find out what jobber in our city is cutting." One dealer wrote, "You may always rely upon us to govern ourselves as per your remarks and trust we may be able to favor you with considerable business during the year." Another stated that they "always have in the past lived up to your resale prices and we fully intend to do so in the future."

The circular also brought a reply from one firm which admitted that it had been departing from the resale discount; that this was due to an error; and that the resale discount list was being maintained. To this the respondent replied in part:

> If we are to continue to do business with you at all we must have a very specific and definite assurance that hereafter there will be no deviation from our resale schedule under any circumstances.

The dealer in question replied to the effect that it would maintain the resale prices suggested by the respondent. After the distribution of this circular among the Baltimore jobbers there was no further complaint of price-cutting in Baltimore.

This constitutes the case in support of the allegations of the complaint. The respondent, for cause why an order to cease and desist the practices charged should not be issued against it, showed that the prices of its tools to the consuming public were not enhanced by the practice and that its prices were below those of its competitors for similar tools. It also showed that the margin which was allowed to its dealers was less than the amount allowed by competitors to their dealers, and that this margin was not in fact, as much as many jobbers thought to be required in order to show a profit on the handling of the respondent's goods. The argument mistakes the nature of these proceedings. The question is not whether the price of the commodity was unduly enhanced but whether an illegal method was employed by the

respondent in endeavoring to secure the maintenance of its suggested resale prices, which had a dangerous tendency unduly to hinder competition among the distributors of the respondent's products. The same disposition may be made of the argument that the removal of the resale discounts and jobbers' discounts would result in an increased price of the respondent's products to the consumer.

The respondent laid stress upon the fact that in but four instances had identical bulletins or form letters been sent to all the dealers in any particular territory. It is apparent from the testimony that this practice would have been used in any other instance in which it had been, in the opinion of the respondent, necessary to follow this practice. Some force was sought to be given to the statement that refusals to sell were limited to the W. J. Baird Company, of Detroit, the Axtel Company, of Fort Worth, the Jackson Supply Company, of Indianapolis, The Foster Supply Company, of Philadelphia, and possibly two others. But this statement cannot be regarded as controlling in view of the fact that in a number of instances upon receiving definite assurances of the intention of the dealer to maintain the resale price schedule, business relations were resumed. The particular instances cited may be regarded as those in which the dealer for one reason or another, failed to give such assurance. The respondent travels five salesmen but it is no part of their duty to investigate to determine whether prices are being cut in any community, and there is no general duty devolved upon dealers to report price-cutting in their vicinity. It appears that in every instance in which a report of price-cutting was made to the respondent where definite information was not given, the reporting dealer was requested to furnish specific information and was given the assurance that it would be acted upon if furnished. This request was in at least four instances followed by a general circularization of the affected territory, resulting in the elimination either by assurances of all concerned of effective resale price maintenance, or a discontinuance of relations with the price-cutter.

While the documentary evidence, and the testimony with relation thereto, ends in 1922, there is no suggestion on the part of the respondent of a discontinuance of its policy or methods, or any variation from the conduct evidenced by the previous expressions of the respondent. In a communication to one of its dealers after the commencement of the investigation by the Federal Trade Commission, the respondent stated in part:

> We ourselves are firmly convinced that our policy is a just one and legally and ethically sound. We are welcoming the prospect of a final solution of the question.

CONCLUSIONS OF FACT

Upon the foregoing findings we arrive at the following conclusions of fact:

1. The selling policy of the respondent is based upon the use of a

base list price with discounts therefrom, by which are fixed the prices to the jobbers and through the jobbers to the consumers.

2. That the respondent divides the territory of the United States into two selling districts in which different resale discounts to the consumer are established for the purpose of assisting to equalize freight differences favoring the eastern territory.

3. That the respondent established this line at the Mississippi River in 1920 and moved it west to the Colorado line in 1922, making the readjustment for the purpose of eliminating, so far as possible, a variation in resale discounts in the western territory.

4. That in locating this line for this purpose the respondent sought and received advice from dealers in the territory affected.

5. That it was the policy of the respondent to take notice of every report from a jobber or dealer of variations from the resale discounts, to make the reporting jobbers or dealers understand that the respondent welcomed such reports, and would enforce its resale price schedule by refusing further sales to the offending dealer if he could be located. That the respondent urged dealers or jobbers making indefinite reports of price-cutting to conduct investigations to determine the identity of the price-cutter and to report such price-cutter to the respondent so that the dealers of the respondent well understood that it was the policy of the respondent to receive reports from its dealers, and to refuse further sales to confirmed price-cutters. That the respondent becoming aware of the identity of a price-cutter refused further relations with such price-cutter unless it appeared that the price variation was due to an excusable error, or the respondent received from the offending dealer a definite and positive assurance in writing applicable both to sales already made and such sales as might be consummated in the future, that the respondent's resale discount schedule would be absolutely maintained. That upon a number of occasions the respondent had insisted upon and received such assurances from dealers or jobbers who had varied from the resale discount schedule.

6. That whenever in the opinion of the respondent it was necessary so to do, either because of the appearance of a considerable departure from the use of the resale discount schedule or because the price-cutters could not be identified, the respondent, both for the purpose of ascertaining the identity of the price-cutters and for the purpose of receiving renewed assurances from its dealers in the affected territory as to resale price maintenance, issued a circular bulletin or form letter to all of its dealers in the affected territory, calling attention to the policy of the respondent for the maintenance of its resale discount schedules; and in effect calling upon each dealer to acknowledge the receipt of the bulletin, circular, or letter in question and to give, in writing, assurances operative both as to sales already consummated and applicable to stock in the dealer's hands, as well as to sales not yet consummated, that the dealer would adhere strictly to the respondent's schedule of resale discounts, upon the penalty stated that

the respondent would refuse business relations with any jobber or dealer who failed to maintain the respondent's suggested resale prices.

7. That this practice was followed with reference to all dealers in the western territory on one occasion, and another time with reference to all dealers in the Pittsburgh territory. Again with reference to all dealers in the Los Angeles territory, and again with reference to all dealers in the Baltimore territory.

8. That in each instance of individual price-cutting reported to the respondent where the respondent could learn the identity of the price-cutter, if the price variation was not satisfactorily explained to the respondent as a mistake and the dealer in question refused to give assurances in writing applicable both to his stock in hand representing consummated sales and to future sales as well that he would be governed by the respondent's suggested resale price, the respondent refused further sales to such dealer.

9. That the respondent sought and secured the cooperation of its dealers in dividing its territory for the purpose of a variation in resale discounts, in order that the location of the dividing line might be a practical means of eliminating variations from the resale discounts operative in each territory. That the respondent sought the cooperation of its dealers in making reports of price-cutters, thereby enabling the respondent to eliminate wilful price-cutters from its list of dealers. That the respondent, whenever it deemed necessary, exacted from its dealers a written assurance that such dealers would both with reference to consummated sales and sales not yet consummated, cooperate with the respondent in the maintenance of its resale prices.

CONCLUSION

That the practices of the said respondent, under the conditions and circumstances herein set forth, are unfair methods of competition in interstate commerce and constitute a violation of Section 5 of an Act of Congress approved September 26, 1914, entitled, "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes."

ORDER TO CEASE AND DESIST

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission, and the briefs and argument of counsel, and the Commission having made its findings as to the facts and its conclusion that the respondent has violated the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes,"

It is now ordered, That the respondent, Toledo Pipe Threading Machine Company, its officers, agents and employees do cease and desist from maintaining its suggested resale discounts by:

1. Requiring from dealers assurance that they will be governed by

the suggested resale discounts in the disposal of stocks previously purchased, as a condition precedent to subsequent sales to them by respondent.

2. Requiring from dealers placing orders assurances that the commodities so ordered will be resold at the suggested resale discounts as a condition precedent to the acceptance of such orders.

3. Requiring from dealers generally assurances that they will be governed by the suggested resale discounts in all resales of respondent's products, under threat of discontinuance of relations.

4. Seeking the cooperation of dealers in making effective a resale price maintenance policy (1) by seeking the advice of dealers as to the location of a selling territorial division line for the stated purpose of eliminating price competition among dealers; (2) by manifesting to dealers an intention to act upon all reports sent in by them of variations from the resale discounts by the elimination of the price-cutter; (3) by informing dealers that price-cutters reported who would not give assurance of adherence to the suggested resale discounts, had been or would be refused further sales; (4) by employing its salesmen to investigate charges of price-cutting reported by dealers and advising dealers of that fact; by which means consecutively or concurrently applied, the aid and assistance of dealers is sought and obtained in the prevention of departures from respondent's resale discounts.

It is further ordered, That the respondent, Toledo Pipe Threading Machine Company, shall within sixty days after the service upon them of a copy of this order, file with the Commission a report in writing setting forth in detail the manner and form in which they have complied with the order to cease and desist hereinbefore set forth.[5]

---

[5] The United States Circuit Court of Appeals for the Sixth Circuit reviewed this order of the Federal Trade Commission and affirmed it with the exception of paragraph 4, which was vacated and concerning which the court's opinion was as follows (11 Fed. (2d) 337):

As to paragraphs 1, 2, and 3, of the order to cease and desist, there is room to think that the requirement of promises from price-cutters, and the assurances in a number of cases, received from them, go far enough to constitute a system of cooperative effort not protected by the manufacturer's individual right of arbitrary selection of customers; and, though with hesitation, we accept that view. As to paragraph 4, we note that subdivision 1 relates to a plan, abandoned three years before, and, so far as we see, never pertinent to the issue, while subdivisions 2, 3, and 4 specify acts which seem to us to be of necessity reasonably incidental to the fair exercise of this right of selection. They represent the irreducible minimum of means by which one who adopts the policy of not selling his goods to price-cutters may endeavor to maintain that policy and the inevitable degree of "cooperation" naturally and selfishly coming from dealers who uphold the system; and they should not be enjoined. We are confirmed in this conclusion by observing, when we analyze the paragraph carefully, and compare, upon one side the clear general right of the respondent to refuse to deal further with price-cutters, and upon the other side the prohibitions of this paragraph:—as to subsection 1: although respondent *may* for the guidance of its own conduct lawfully formulate its schedules of desired resale prices with due regard to varying freights, it *may not* lawfully consult its dealers as to what would be fair treatment to them in this respect. As to subsection 2: respondent lawfully *may* act upon any report of price-cutting, spontaneously sent in, in his own interest, by a dealer; hence, of course, it *may* lawfully have the intention so to act; but it *may not* manifest this intention. As to subsection 3: respondent lawfully *may* cut off a reported price-cutter who is, in its view, contumacious; it rightly may intend to do so; but it *may not* inform dealers that it so intends. As to subsection 4: respondent *lawfully may* discontinue trade with one charged to be a price-cutter, and *fairly may* do so if the charge is true; but it *may not* have its salesman investigate the truth of the charge and advise dealers thereof. These distinctions do not appeal to us as having any basis in sound reasoning.

COMMENTARY: The respondent in this case was selling tools for industrial equipment to jobbers who resold to users; it also accepted orders directly from industrial users, but at the same prices as those charged by jobbers. Therein was one ground for nominally differentiating this case from the Beech-Nut case, since the wholesale distributors of the Beech-Nut Packing Company resold the company's products to retailers.[6] That difference was not material, however, to the fundamental issue, and reference to it here serves merely to indicate the pervasiveness of the problem of price-cutting.

The company established a dividing line, first, at the eastern boundary of Colorado, then at the Mississippi River, and later at the Colorado line again—to separate the country into two regions to which different discounts and hence different resale price suggestions applied. The commission referred to this practice, it stated, not as a basis for its decision but because of the light which the practice threw upon the general policy of the respondent. The practice affords an interesting example of the problems which arise as a result of variations in freight rates when a company attempts to standardize resale prices.

The company suggested resale prices and stated straightforwardly that it proposed to have them maintained. The respondent, when informed of price-cutting, did not acquaint the informants explicitly with the action taken in each instance, as did Hills Brothers under similar circumstances,[7] but did advise them in general terms of the action which it proposed to take. Such advice was, in effect, merely a restatement of the company's general pronouncement of policy. Since the respondent must have been assumed to be honest and honorable, such objection as the commission had to these practices must have been primarily to the general pronouncement rather than to the individual restatements of that policy.

The commission's decision in this case, which is analogous to its decisions in several other cases, seems to amount briefly to this: it does not deny the right of a manufacturer to suggest resale prices, but it does hold a manufacturer who suggests resale prices to be guilty of unfair trading if he announces that he will secure observance of the resale prices which he has suggested or else refuse to sell goods to the price-cutters.

The basic issue was the same in this case as in the Beech-Nut case referred to above, but here the situation was simpler and the unsoundness of the precedent set by the decision in the Beech-Nut case stands forth more clearly.

June, 1926 M. T. C.

[6] Federal Trade Commission *v.* Beech-Nut Packing Company, page 479.

[7] Federal Trade Commission *v.* Hills Brothers, page 559.

Federal Trade Commission *v.* Hills Brothers[1]

MANUFACTURER—COFFEE

Price Maintenance—*Standardization of Resale Prices by Cooperative Means Held Illegal.* The Federal Trade Commission ordered the company, which manufactured and sold directly to retailers coffees, teas, spices, and similar products, to discontinue: requiring as a condition of sale that customers agree not to sell certain brands of its coffees below specified prices; soliciting from salesmen and retail customers reports of retailers failing to observe the specified prices, and refusing or threatening to refuse sales to retailers so reported; utilizing other equivalent cooperative means of maintaining resale prices.[2]

(1925)

COMPLAINT

Acting in the public interest pursuant to the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes," the Federal Trade Commission charges that Hills Brothers, hereinafter referred to as respondent, has been and is using unfair methods of competition in interstate commerce in violation of the provisions of Section 5 of said Act, and states its charges in that respect as follows:

Paragraph 1. Respondent is a corporation organized and existing under and by virtue of the laws of the state of California, having its main office and place of business in San Francisco, in said state. It is now and at all the times hereinafter mentioned has been engaged in the business of roasting coffees and in the sale of coffees, teas, spices, and other similar products to retail dealers in various states of the United States, and it causes said products when so sold to be transported from its said place of business in the state of California to purchasers thereof in various other states, and has been and now is in active competition with other individuals, partnerships, and corporations similarly engaged.

Par. 2. In or about the year 1920 respondent adopted and has since employed a merchandising plan or policy for certain brands of its roasted coffee by which it established a system of resale prices for said products, varying roughly according to the respective transportation charges to different localities, which prices respondent required and still requires its various distributors to observe as the respective

[1] Federal Trade Commission, Docket 1006, January 28, 1925.

[2] Headnote by Graduate School of Business Administration.

minimum prices to be charged by them in reselling said products to the purchasers thereof in their respective localities.

Par. 3. In order to carry out the said plan or policy, and to secure the cooperation therein of dealers generally, the respondent adopted and employed and still employs the following among other means by which it and those cooperating with it have undertaken to prevent and have prevented other dealers from selling said products at prices less than the said minimum resale prices so established by respondent:

(*a*) It issues resale price-lists to the trade in which lists the various minimum resale prices for its said products are set forth and explained;

(*b*) It makes it generally known to the trade by letters, circulars, salesmen's interviews, and other means that it expects and requires retail dealers handling its products to maintain and enforce said minimum resale prices;

(*c*) It enters into informal agreements, understandings, and arrangements with retail dealers for the maintenance of said minimum resale prices in their respective localities as a condition of opening accounts with such dealers or of continuing their supply of its products;

(*d*) It invites and procures from retail dealers handling its products reports as to the failure of other dealers to observe and maintain said minimum resale prices;

(*e*) It directs its salesmen and other employees to secure information as to retail dealers who fail to observe said minimum resale prices;

(*f*) It uses information received through its distributors or employees to induce and coerce such dealers as have failed to observe said prices to maintain the same in the future by exacting promises and assurances from them to that effect, and by threatening that if such prices are not maintained further goods will not be supplied to them by respondent;

(*g*) It threatens to refuse and does refuse to sell its products to dealers failing to observe and maintain said minimum resale prices;

(*h*) It favors dealers who maintain said prices by discriminating against competing dealers who fail to observe the same;

(*i*) It makes a record in the appropriate ledger accounts, or otherwise, of all instances coming to its knowledge in which dealers handling its products have failed to observe and maintain said minimum resale prices;

(*j*) It refuses to supply such dealers with further goods until they have given satisfactory assurances for the maintenance of such prices in the future;

(*k*) It seeks and secures the cooperation of its distributors

generally in preventing other distributors from obtaining respondent's said products, by reason of failure to maintain said resale prices;

(*l*) It has used and now uses other equivalent cooperative means and methods for the enforcement of said system of minimum resale prices; all with the result that its said prices have been and are generally observed and maintained by distributors handling said products.

Par. 4. The above acts and practices of respondent have had and still have the capacity and tendency to constrain all dealers handling respondent's said products to sell the same at or above the minimum resale prices fixed by respondent as aforesaid, and prevent such dealers from selling such products at such less prices as they might or may deem to be warranted by their respective costs and efficiency, and hence to hinder and suppress all price competition in the resale of such products in the various localities in which the same are sold; thus tending to obstruct the free and natural flow of commerce in such products and the freedom of competition in this channel of interstate trade.

Par. 5. The above acts and practices of the respondent are all to the prejudice of the public and respondent's competitors and constitute unfair methods of competition in commerce within the intent and meaning of Section 5 of an Act of Congress entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes," approved September 26, 1914.

REPORT, FINDINGS AS TO THE FACTS, AND ORDER

Pursuant to the provisions of an Act of Congress approved September 26, 1914, the Federal Trade Commission issued and served a complaint upon the respondent, Hills Brothers, charging it with the use of unfair methods of competition in commerce in violation of the provisions of said act.

Respondent having entered its appearance and filed its answer herein, hearings were had and evidence and testimony were thereupon introduced in support of the allegations of said complaint before an examiner of the Federal Trade Commission, theretofore duly appointed.

And thereupon this proceeding came on for final hearing, and counsel for the Federal Trade Commission and counsel for Hills Brothers having submitted briefs and having argued the case before the Commission, the Commission, having duly considered the record and being now fully advised in the premises, makes this its findings as to the facts and conclusion:

FINDINGS AS TO THE FACTS

Paragraph 1. The respondent, Hills Brothers, is a corporation organized and existing under and by virtue of the laws of the state of Cali-

fornia, with its principal place of business in the city of San Francisco in said state. The respondent company was incorporated in February, 1914, and its capital stock is $2,000,000. Its officers are A. H. Hills, president; R. W. Hills, vice-president; E. M. Cofer, vice-president and general manager; G. H. Hills, vice-president; E. B. Hills, vice-president; R. W. Hills, Jr., vice-president; and P. L. Johnson, secretary. Respondent is engaged in the business of importing coffee from Brazil, Central America, Colombia, Hawaiian Islands, and Dutch East Indies, and, after roasting, grading, blending and packing the same, selling it in the United States. At the present time respondent deals only in coffee. It formerly imported and sold teas and spices but has discontinued dealing in those commodities.

Par. 2. Respondent sells its coffee direct to the retail dealers in food products. In some of the Western States it also sells to a few jobbers but at the same list price at which it sells to the retail dealers. Respondent also has in some of the eastern states wholesale dealers to whom it allots exclusive territory in the sale of its coffee. Respondent has about 25,000 customers to whom it sells its coffee. About 54% of these are located within the state of California, and the remaining 46% are located in various other states of the United States but principally in the states of Washington, Oregon, Montana, Idaho, Utah, Colorado, Arizona, New Mexico, Nevada, Wyoming, and Missouri.

Respondent employs about 61 salesmen who visit the retail grocers and other retail dealers selling food products and solicit orders for its coffee. These salesmen are under the general direction of a sales manager who is located at the respondent's principal place of business in San Francisco. Respondent maintains branch offices in Los Angeles, California; Portland, Oregon; Seattle, Washington; Butte, Montana; Salt Lake City, Utah; El Paso, Texas; and Denver, Colorado; which offices are in charge of branch office supervisors. At its branches respondent also maintains storage facilities, where it keeps a stock of its coffee and from which stock it supplies its customers in the adjacent territory.

Respondent markets its coffee under brands or trade names, among which are Red Can Brand, Blue Can Brand, Restaurant Special, and three brands of bulk coffee. The brand of coffee which respondent advertises most extensively is Red Can Brand, and those in which its volume of sales is the largest are the Red Can Brand and the Blue Can Brand. Coffee sold under the Red Can Brand is packed in vacuum tins in half-pound, one-pound, two-pound, two-and-one-half-pound, five-pound and twenty-pound sizes. Coffee sold under the Blue Can Brand is packed in paper cartons in one-pound, three-pound and five-pound sizes.

Respondent has created a demand for its coffee on the part of the consuming public by means of advertising in the states in which it does business. Respondent advertises extensively, using such mediums

as billboards, street-car advertising, store and window displays, and newspapers. In the year 1923 respondent sold approximately 25,000,000 pounds of coffee, of which about 21,000,000 pounds was Red Can Brand and about 3,500,000 pounds was Blue Can Brand. About 44% of respondent's sales were outside the State of California.

Respondent causes the coffee it sells to be transported from its principal place of business in San Francisco, California, or from one of its branch offices and storage houses which are located in various states, through and into various other states of the United States where the purchaser resides.

Par. 3. On November 5, 1920, respondent adopted a policy or plan of designating the minimum price at which the retail dealer should sell respondent's coffee to the consuming public. The plan adopted provides that the retail dealer must sell respondent's coffee for not less than 5 cents per pound above "store cost." "Store cost" is the list price at which the retailer buys the coffee, plus the transportation expense. Respondent's minimum resale price applies only to respondent's Red Can and Blue Can brands of coffee. Respondent's purpose in adopting this resale price policy was to make the price of its Red Can and Blue Can brands of coffee uniform in the various localities in which they were sold, and to prevent price-cutting by dealers. The plan does not prevent the retail dealer from charging more than the 5-cent margin allowed, but in some instances respondent's salesmen have questioned the wisdom and advisability of retail dealers selling respondent's coffee at higher than the minimum resale price where said retail dealers have offered for sale and sold the coffee at such higher prices. The fixing of a minimum resale price by respondent has the tendency to cause retail dealers to regard the said minimum resale price as a maximum resale price, and the great majority of dealers handling respondent's coffee do sell it at the said minimum resale price and no other.

Par. 4. Respondent made its minimum resale price plan known to the retail dealer by first issuing a bulletin to all its salesmen, and they in turn informed respondent's customers. Later respondent caused advertisements of its minimum resale price plan to be published in retail grocery trade papers which had wide circulations in the states in which it sold its coffee. It also mailed to each of its customers copies of the advertisement that appeared in the said trade papers. Respondent's salesmen from time to time call to the attention of the retail dealer the minimum resale price plan. Particularly is this done when calling on a dealer to solicit business the first time.

Par. 5. When respondent makes any change in the price of its Red Can and Blue Can brands of coffee, it notifies its branch offices and salesmen and they in turn notify the retail dealer. Notice is given the retail dealer either by telephone, a personal call, or by mailing a card. In some instances the new price quoted is the price at which the

retail dealer is to sell to the consumer. At other times it is the new list price at which respondent sells coffee to the retail dealer. In the latter case the retail dealer adds 5 cents per pound to the price quoted, to comply with the respondent's minimum resale price plan.

Par. 6. Respondent enforces its minimum resale price plan by refusing to sell its coffee to a retail dealer who sells Red Can Brand or Blue Can Brand coffee for less than the minimum resale price established by respondent. When respondent learns that a retail dealer is selling its coffee below the minimum resale price, and the said retail dealer will not, after being solicited by respondent's salesmen, restore the price to that provided in respondent's plan, no more orders for coffee from that retail dealer will be filled by respondent. Since adopting its resale price plan respondent has refused to sell its coffee to approximately 100 retail dealers, located in various states, for failure to maintain the minimum resale price.

Par. 7. Respondent learns of instances where its minimum resale price is cut, from its salesmen and from competing retail dealers located near the dealer cutting the price. The salesmen report instances of price-cutting in their respective territories to respondent, and invite and procure from the retail dealers upon whom they call, reports of the failure of competing dealers to maintain the minimum resale price, which reports the salesmen transmit to respondent. Retail dealers selling respondent's coffee continually advise respondent's salesmen whenever a competitor cuts the minimum price established by respondent, and often telephone to one of respondent's branch offices and report instances of price-cutting by competitors. These reports by retail dealers are solicited and requested by respondent's salesmen, who assure the retail dealers that if the offending dealer persists in selling below the minimum resale price respondent will refuse to sell him any more coffee.

Par. 8. When a retail dealer is reported for failure to maintain the minimum resale price, one of respondent's salesmen calls upon the said dealer and endeavors to obtain a promise from him that he will restore the minimum resale price. The salesman threatens the offending retail dealer that if he does not restore such resale price, and promise to observe it in the future, his name will be taken off respondent's list of customers, and he will be unable to obtain any further supplies of respondent's coffee. Upon promises by the retail dealer of his intention to restore and maintain the minimum resale price the salesman assures him that respondent will continue to fill his orders for coffee, which it does.

Par. 9. Retail dealers also often voluntarily report instances of failure to observe the minimum resale price by competitors, direct to respondent's main office. Upon receiving such a report respondent writes a letter to the dealer who is not maintaining the price, calling his attention to respondent's resale price plan and requesting the deal-

er's approval and cooperation. Respondent also writes a letter to the dealer making the report, thanking him for the information, and enclosing a copy of the letter sent the dealer who has failed to maintain the price. By this means respondent encourages its dealer customers to report to it all instances of price-cutting which come to their attention. Respondent is always prompt to acknowledge and investigate reports of failure on the part of its dealer customers to observe the minimum resale price.

Par. 10. Whenever a dealer refuses to maintain respondent's minimum resale price and he is refused a further supply of coffee, his name is removed from respondent's list of customers. This is accomplished by placing a sticker on the dealer's ledger folio or ledger card, upon which sticker the words "Do Not Sell" are written. These stickers are also used when a customer is removed from the list for other reasons than the failure to maintain the resale price.

Par. 11. When a dealer has been refused further supplies of respondent's coffee for failure to observe the minimum resale price, and his name has been removed from respondent's list of customers, his name will not be restored to the list and he can not again buy its coffee from respondent until he has given satisfactory assurances that he will follow the minimum resale price established by respondent in the future. Respondent's Red Can and Blue Can brands of coffee are so well and favorably known in the Pacific Coast and Rocky Mountain sections of the United States that they are almost a necessity for a retail grocer to have in stock at all times.

Par. 12. Respondent marks on the can in which it packs Red Can Brand coffee the date on which the coffee is packed, in code. The marking is not such a one that it would enable an employee of respondent, or any other person, to identify any can of coffee as being one of a certain shipment. No record is kept of what particular packages, cans, tins or cases are used to fill orders, and it is impossible to identify any particular can or package of coffee as being part of any order.

Par. 13. The minimum resale price policy and practice of respondent, as applied to its Red Can Brand and Blue Can Brand coffee, as hereinbefore set forth, have the tendency and capacity to and do constrain all retail dealers handling said brands of respondent's coffee uniformly to sell the aforesaid coffee to the public at the prices fixed by respondent for the respective territories in which they are located, and further to hinder and restrict competition between retail dealers handling respondent's said brands of coffee. Respondent's said practices tend to and do unduly hinder and obstruct competition in the sale and distribution of coffee in the course of interstate commerce.

CONCLUSION

The methods of competition set forth in the foregoing findings are, under the circumstances therein set forth, unfair methods of competi-

tion in interstate commerce in violation of the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes."

ORDER TO CEASE AND DESIST

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission, the answer of the respondent, the testimony and the evidence, and the Commission having made its findings as to the facts, with its conclusion that the respondent has violated the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes,"

Now, therefore, it is ordered, That respondent, Hills Brothers, its officers, directors, agents, servants, and employees, cease and desist from directly or indirectly carrying into effect by cooperative methods a system of minimum resale prices at which the articles manufactured by it shall be resold by its distributors and retail dealers, and more particularly by any or all of the following means:

1. Requiring purchasers or prospective purchasers to agree that they will not resell below a minimum price specified by respondent.

2. Utilizing its salesmen for the purpose of enforcing cooperation in its resale price maintenance plan, to report retail dealers who do not observe its suggested minimum resale price, or acting on reports so obtained by refusing or threatening to refuse sales to dealers so reported.

3. Requesting dealers, either directly or through its salesmen, to report competitors who do not observe the minimum resale price suggested by respondent, or acting on reports so obtained by refusing or threatening to refuse sales to dealers so reported.

4. Requiring from retail dealers previously cut off because of price-cutting, promises or assurances of the observance of respondent's minimum resale price as a condition precedent to reinstatement of said dealers.

5. Requiring from retail dealers charged with price-cutting, promises or assurances of the observance of respondent's minimum resale prices as a condition precedent to future sales to said dealers.

6. Causing retail dealers to be enrolled upon lists of undesirable purchasers who are not to be supplied with the products of the company unless and until they have given satisfactory assurances of their purpose to maintain such minimum resale prices in the future.

7. Utilizing any other equivalent cooperative means of accomplishing the maintenance of minimum resale prices fixed by respondent for its product.

It is further ordered, That respondent, within 60 days after service upon it of this order, file with the Commission a report in writing,

setting forth in detail the manner and form in which it has complied with the order to cease and desist hereinbefore set out.[3]

By the Commission, Commissioner Gaskill dissenting.

Commentary: Unlike the Beech-Nut Packing Company, Hills Brothers sold its products directly to retailers. It placed no serial numbers or other identifying marks on its shipping cases or packages to facilitate the tracing of shipments of merchandise offered for sale at cut prices as did the Beech-Nut Packing Company. In other respects this case is quite similar to the Beech-Nut case.[4]

Hills Brothers suggested resale prices. It encouraged salesmen and customers to furnish information on price-cutting. When instances of price-cutting were brought to the firm's attention, it remonstrated with the price-cutters and, if the remonstrances were ineffective, it refused to accept further orders from the recalcitrants. These practices constituted an especially simple method of using moral suasion and refusal to sell as means of securing the observance of suggested resale prices.

The firm, to be sure, indicated by notations in its ledgers the customers to whom further sales were not to be made. But such notations, or other records, were essential if the company was privileged to refuse to sell to any customers. The right to refuse to sell without the privilege of keeping a record of those former customers to whom no sales were to be made, would be a shadowy right. The firm also sent copies of its letters to price-cutters to the customers who had brought the price-cutting to its attention. This practice may have been of doubtful propriety, but surely it was the action taken toward the price-cutters, not the informatory letters regarding that action, which was of chief significance. In this case, again, the basic question was the right of the seller to suggest resale prices, and the inconsistency of the Beech-Nut decision in affirming that right while denying means of effectively exercising the right is once more apparent.

June, 1926 M. T. C.

[3] This order of the Federal Trade Commission was reviewed and affirmed by the United States Circuit Court of Appeals for the Ninth Circuit, 9 Fed. (2d) 481.

[4] Federal Trade Commission *v.* Beech-Nut Packing Company, page 479.

Federal Trade Commission *v.* Q. R. S. Music Company[1]

MANUFACTURER—MUSIC ROLLS

Price Maintenance—*Standardization of Resale Prices by Cooperative Means Held Illegal.* The Federal Trade Commission ordered the company, a manufacturer of music rolls for player pianos, to discontinue the use of cooperative means of maintaining uniform resale prices. Practices specifically prohibited were: entering into contracts, agreements, or understandings with retailers; requesting retailers or the company's own employees to report retailers not observing the suggested resale prices; refusing to sell or threatening to refuse to sell to retailers so reported.[2]

Distribution Channels—*Exclusive Agency Agreement Binding Retailers Not to Deal in Competing Products Held Illegal.* In a proceeding which it brought against the company, a manufacturer of music rolls for player pianos, the Federal Trade Commission found that the company had entered into agreements with a number of retailers whereby such retailers undertook not to sell the products of any competitor of the company. The commission held that such exclusive agency agreements substantially lessened competition in the sale and distribution of music rolls and ordered the company to discontinue the practice of making such agreements.[2]

Price Maintenance—*Acceptance of Returned Goods to Prevent Price-Cutting.* The company, a manufacturer of music rolls for player pianos, permitted retailers to whom it sold under exclusive agency agreements, to return music rolls which they were unable to sell at the company's established resale prices. The value of the goods returned was credited against future orders from the retailers. In some instances the exchange privilege was confined to a percentage of the retailers' purchases.[2]

(1924)

Findings as to the Facts

Paragraph 1. Respondent, The Q. R. S. Music Company, is a corporation organized, existing and doing business under and by virtue of the laws of the state of Illinois, with its principal place of business in the city of Chicago, in said state.

(*a*) "Q. R. S." are letters of the alphabet adopted arbitrarily as part of the name or title and are not abbreviations of a longer title. Prior to 1910, when it was absorbed by the Melville-Clark Piano Company, Q. R. S. Music Company was an independent concern. Subsequent to

[1] *Federal Trade Commission* v. *The Q. R. S. Music Company,* Docket 793—April 8, 1924.

[2] Headnote by Graduate School of Business Administration.

that time, until 1920, Melville-Clark Piano Company conducted its player roll business under the name Q. R. S. Music Company. February 9, 1920, Melville-Clark Piano Company changed its corporate name to The Q. R. S. Music Company, the respondent herein.

(*b*) While The Q. R. S. Music Company has about three hundred stockholders, it is essentially a close corporation, since a majority of its capital stock is owned and held by four persons: Alfred N. Page, secretary; Thomas M. Fletcher, president; Mr. Kisselhorst and Mr. Roberts.

Par. 2. Respondent is engaged in the business of manufacturing and selling music rolls for player pianos. It has factories for the manufacture of such rolls in Chicago, New York, San Francisco, and Toronto, and sales offices at each of these points from which it sells and distributes its said music roll products in the several states of the United States and also in foreign countries.

(*a*) The great bulk of the music roll product manufactured, sold, and distributed by respondent in the several states of the United States has been known as Q. R. S. player rolls, the letters Q. R. S. having been copyrighted as a trade designation for such rolls.

Par. 3. In the course and conduct of its said business as set forth in paragraph 2 hereof, respondent has been and is in competition with other persons, partnerships, firms, and corporations engaged in the manufacture and sale of similar products in interstate commerce.

Par. 4. (*a*) The commercial production and sale of player rolls have developed largely in the past twenty-five years. Since 1910 such development has been extremely rapid, as shown by the growth of respondent's annual production. According to records produced by respondent, its output in 1910 was approximately 157,000 rolls valued at $73,752; and in 1920, the banner year of its production, respondent manufactured in excess of 6,200,000 rolls valued at $3,690,601.

(*b*) By its rapid strides in the manufacture of music rolls, respondent has become the leading manufacturer of music rolls for player pianos in the United States, as shown by a comparison of respondent's annual output with the output of the entire industry. The estimated output of music rolls of the entire industry at the date of hearing herein was between 10 and 12 million. This annual production contrasted with respondent's production in 1920 of 6,200,000 rolls, gives the respondent a control of well over 50% of the industry.

(*c*) Respondent's rolls sell generally at higher prices than the rolls of competitors, so that its percentage of the gross business in dollars and cents is substantially larger than in number of rolls.

(*d*) Respondent's Q. R. S. music rolls are considered in the trade as of high quality and the fact that they are nationally advertised creates a brisk demand for them. Dealers in music rolls for player pianos find their business success in this line promoted by ability to furnish their customers with Q. R. S. player rolls.

Par. 5. Respondent sells the great bulk of its player rolls above-mentioned through retail dealers in music or musical instruments, and in kindred lines permitting the stocking and sale of such accessories as music rolls, sheet music, and phonograph records. These dealers are located in the several states of the United States and in foreign countries, and are estimated to number in all about 7,500.

(*a*) Customers of respondent east of the Allegheny Mountains are largely served from its factory and sales office in New York City. Customers of respondent in the Ohio and Mississippi valleys are largely served from its factory and sales office in Chicago. Customers west of the Rocky Mountains are largely served by respondent from its factory and sales office in San Francisco. Export business is conducted largely from the factory and sales office of respondent in New York City. Some customers in territory ordinarily served by the New York and San Francisco offices are served from the factory and sales offices in Chicago.

(*b*) Respondent also sells its player rolls through several jobbers, but not more than 5% to 10% of its total product is thus distributed.

(*c*) Respondent employs about thirty-five salesmen who sell its product to dealers and make preliminary arrangements with dealers as to the exchange of its player rolls.

(*d*) Respondent issues catalogs, bulletins, or price-lists from time to time, listing its said player rolls. It also advertises its products nationally and locally. In its local advertisements it furnishes literature to dealers handling its player rolls, or supervises and directs advertisements of such player rolls by dealers, in local advertising mediums.

(*e*) Respondent sells its rolls f.o.b. factories or point of shipment to the dealers who become its distributors. Such dealers, as well as the officers of respondent, consider the title to such rolls passes to the dealer purchaser as soon as respondent makes shipment and remains in said dealer while he retains possession.

(*f*) Respondent's Q. R. S. player rolls are priced to dealers by means of price-lists and discount sheets; "Confidential Discount Sheet, 1920 Q. R. S. Rolls" provides that "on purchases under 5,000 rolls in one year the discount is 40%; on purchases of 5,000 rolls within one year the discount will be 40% and 10%. The extra 10% will be retroactive and credited to all purchases in 1920. On purchases amounting to 12,000 rolls or more per year the discount will be 50% applicable as above."

Terms to the dealers are 30 days net with an extra 2% discount allowed on all purchases paid for by the 10th of the month following the purchase. Dealers make payments ordinarily for respondent's player rolls upon these terms, such payments being in no way contingent upon the sale of the rolls by dealers.

Par. 6. Respondent has employed in the sale of its Q. R. S. player

rolls, a policy and practice of fixing and prescribing from time to time the prices at which said player rolls shall be resold by retail dealers to consumers.

(*a*) In connection with such resale-price maintenance policy and as a means of carrying it out and enforcing it in connection with the sale and distribution of Q. R. S. player rolls, respondent has issued catalogs, price lists, and other literature in which resale prices are suggested for respondent's Q. R. S. player rolls. Respondent has caused such resale prices to be placed upon the labels of Q. R. S. player rolls and upon the boxes containing such rolls.

(*b*) Respondent has advised dealers and has let it be known to the music roll trade generally, that it regards its resale-price maintenance policy with regard to its Q. R. S. player rolls as vital to its business, and that to enforce such policy respondent would refuse to sell to any dealer who had cut the resale price of Q. R. S. rolls fixed by respondent.

(*c*) Such references to its resale-price maintenance policy have been made by respondent in its application blanks used by dealers in initiating their purchases of Q. R. S. player rolls, in circular letters and in correspondence with the respondent's customers and its salesmen.

(*d*) Before listing dealers as "authorized" and before selling them Q. R. S. player rolls, respondent asks them to fill out and sign a blank application indicating the sort of merchandise carried by applicant, the distance away of the nearest Q. R. S. dealer, the number of dealers in the city where applicant is located, whether applicant has theretofore carried or sold Q. R. S. rolls, what lines of rolls are then carried by applicant, whether applicant carried player pianos and if so, what kind and from whom purchased. The applicant is asked to give three references, and near the end of the blank occurs this printed statement:

"IMPORTANT

"The policies of Q. R. S. Music Company must be strictly adhered to in the marketing and retailing of rolls."

(*e*) This application is transmitted by respondent to the dealer with a letter requesting the applicant to fill out, sign and return it to respondent. When the dealer is accepted by respondent as a customer he is sent a form letter in which this paragraph occurs:

> "Our list price insures a fair profit only, and the protection of that profit is vital to us both. We will be glad to have your co-operation in advising us of any sale of our products that comes to your notice, that is detrimental to our mutual interests."

(*f*) Pursuant to the aforesaid policy of resale-price maintenance respondent has requested its customers to report to it competing dealers who sell Q. R. S. player rolls for less than the resale price named by respondent in its catalogs, and its customers have in fact so reported such dealers to respondent. Respondent has also received from its

salesmen and agents reports concerning dealers who sell Q. R. S. rolls for less than the resale prices named by it in its catalogs.

(*g*) Following such reports and with such reports as a foundation, respondent has endeavored to secure from the dealers reported agreements and promises to maintain respondent's resale prices upon Q. R. S. player rolls, giving such dealers to understand that unless they did so they could no longer buy Q. R. S. player rolls from respondent.

(*h*) Acting upon information as to price-cutting by competing dealers, received from customers, salesmen, or agents, respondent has sought and secured from such competing dealers, agreements to restore, observe, and maintain the resale prices upon Q. R. S. player rolls named by respondent in its catalogs.

(*i*) At the demand of a customer who was a competitor of other customers of respondent in the sale of Q. R. S. player rolls, respondent has brought pressure to bear upon such other customers to restore, observe, and maintain the resale prices upon Q. R. S. player rolls named by respondent in its catalogs, and such action has been taken as a condition upon which the demanding customer promised to continue to observe and maintain such resale prices.

(*j*) At the demand of customers who were competitors of other customers in the sale of Q. R. S. player rolls respondent has cut off or refused to sell such other customers, because such other customers had failed or refused to observe and maintain the resale price of Q. R. S. player rolls named by respondent in its catalogs, and such action was taken as a condition upon which such demanding customers continued to observe and maintain the resale prices named by respondent on Q. R. S. player rolls.

(*k*) In carrying out its aforesaid policy of resale-price maintenance, respondent has refused to sell to dealers who persisted in cutting the resale price fixed by respondent for Q. R. S. player rolls.

(*l*) In the course of its said business respondent has refused to sell to dealers who would not promise to observe and maintain its resale price upon Q. R. S. player rolls.

(*m*) The resale price suggested by respondent is maintained by 99% of its dealers, and the number of respondent's dealers who have cut respondent's resale price during the last ten years and who were known by respondent to have done so, has not exceeded fifty in all.

(*n*) In the maintenance of said resale prices upon Q. R. S. player rolls, respondent has a system of cooperative advertising and selling helps for dealers, these selling helps being extended only to dealers who maintain the resale prices named by respondent for Q. R. S. player rolls, and this cooperation is withdrawn from such dealers as respondent refuses to sell because of their failure to maintain said resale prices.

(*o*) Respondent's adoption and enforcement of its policy of resale-price maintenance as hereinabove set forth has secured for Q. R. S. rolls advantages in competition over the music rolls of other manufac-

turers, because of the fact that dealers in such rolls prefer to sell and distribute music rolls upon which the manufacturer suggests, maintains, and enforces uniform resale prices and because of the fact that certain other manufacturers, competitors of respondent, do not require their dealers to maintain resale prices.

Par. 7. Respondent's policy of maintaining resale prices upon Q. R. S. player rolls in the manner and by the methods hereinabove set forth has had the effect of establishing a uniform price upon such rolls purchased by the consumer from any dealer; said policy has also had the effect of preventing dealers from selling such rolls at lower prices such as might be found by them adequate and warranted by their respective selling costs and efficiency. Respondent's resale price policy has also had the effect of lessening or eliminating competition between and among such dealers in the sale of Q. R. S. player rolls.

Par. 8. Respondent, in the course of its business as hereinabove described, has entered into agreements with dealers for the sale and distribution of Q. R. S. rolls, by which such dealers undertake to deal exclusively in player rolls made and sold by respondent, and not to buy, sell, or deal in player rolls made by any competitor of respondent except such character, class, or kind of roll as is not made or sold by respondent and cannot be secured from it.

(*a*) During the space of about a year running from March 29, 1920, to July 21, 1921, respondent entered into such exclusive dealing agreements with numerous dealers scattered through various states of the United States, and business in Q. R. S. player rolls was carried on between respondent and such dealers pursuant to such agreements. The making of such agreements with dealers distributing Q. R. S. player rolls made and sold by respondent was the regular practice and policy of respondent.

(*b*) Respondent's salesmen, when calling upon such dealers, advised them that exclusive dealing arrangements might be made with respondent, and solicited them to make such arrangements. These talks of the salesmen of respondent with the dealers were often followed by respondent's sending such dealers memoranda giving specifically the conditions upon which exclusive dealing arrangements might be made.

(*c*) In many instances such dealers addressed letters to respondent incorporating more or less specifically in their offers of exclusive dealing, the conditions set forth in respondent's aforesaid memoranda. These offers were accepted by respondent as made, or with modifications, and resulted in exclusive dealing arrangements between such dealers and respondent, under which were conducted the sale and distribution of Q. R. S. music rolls.

(*d*) This method of initiating exclusive dealing agreements was adopted to cover up the fact that such agreements were solicited by respondent and to give the impression that they were made in response to spontaneous offers from customers.

(*e*) The consideration flowing from respondent to such dealers for exclusive dealing in Q. R. S. player rolls in most instances included a so-called unlimited exchange privilege, by which respondent agreed to credit against future orders from the dealer the amount paid by such dealer for Q. R. S. player rolls which the dealer was unable to sell and which he returned with seals unbroken or in a salable condition, to respondent. Such return and exchange was limited by respondent in 1921 to rolls purchased from respondent within the previous four months. In some cases, also, the unlimited privilege was curtailed and the exchange privilege of the dealer was confined to a percentage of the dealer's purchases. Exchange privileges could be exercised but once a month.

(*f*) Such unlimited exchange as was granted its exclusive dealers by respondent, as herein described, was equivalent to a rebate upon the purchase price paid for said goods by said dealers to respondent.

(*g*) In addition to the unlimited exchange privilege based upon exclusive dealing, respondent gave to dealers selling and distributing both Q. R. S. player rolls and the rolls of other manufacturers, a limited exchange privilege by which such dealers were permitted to return to respondent once a month 5% of the quantity of Q. R. S. player rolls purchased by such dealers during the previous month. In each case the return of such rolls was coupled with an exchange and the number of rolls returned was not permitted to exceed the number of new rolls ordered at the time of the return. Credit for the rolls returned applied not to accounts already contracted by the dealer making the return but only to purchases made at or after the time of the return. The limited return or exchange privilege could be exercised but once each month, and if not exercised for any one month, lapsed and could not thereafter be exercised as to purchases made for the month that had been neglected.

(*h*) Regulations for exchanges under the unlimited exchange privilege and under the limited exchange privilege were sent by respondent to dealers in Q. R. S. player rolls in the form of a blank designated "Application for exchange." On the front of such blank appeared forms for listing and numbering the rolls to be exchanged, and on the reverse side appeared printed conditions or regulations, under which the exchange was made. These printed conditions or regulations, however, did not include any reference to exclusive dealing with respondent.

(*i*) About 1921 respondent purchased the plant and property of the Rythmodic Company, which, as a branch of the American Piano Company, was at that time manufacturing in New York City about 500,000 player rolls a year. In 1922 respondent acquired the roll business of the Cable Piano Company of Chicago, which was being conducted under the name of Imperial Player Roll Company with headquarters in the city of Chicago. Imperial Player Roll Company had been in business since 1904, and at the time of its acquisition by respondent was manufacturing about 1,000,000 player rolls a year. Respondent, after its

acquisition of the Rythmodic and Imperial player roll businesses, offered to dealers with whom it had exclusive agreements for handling Q. R. S. player rolls, Rythmodic and Imperial rolls covering such selections as could be furnished in Q. R. S. player rolls. Upon Rythmodic and Imperial rolls no resale price was named and said dealers were advised that upon such rolls they might sell at any price they chose, and thus meet the demand for rolls which were lower-priced than Q. R. S. rolls, without patronizing competitors of respondent. Said Rythmodic and Imperial rolls were also sold by respondent to dealers generally without restriction as to the resale price.

Par. 9. Such agreements for exclusive dealing as set forth in paragraph 8 hereof, under the conditions and in the circumstances therein set forth, have had the effect of causing dealers in player rolls to discontinue the handling of player rolls manufactured and sold by competitors of respondent and to prevent such dealers in player rolls from selling or distributing player rolls made by manufacturers who were competing with respondent.

(*a*) Respondent's unlimited exchange plan as hereinabove set forth, has caused dealers in music rolls who have exclusive trading agreements with respondent to refuse to buy, sell, deal in, or distribute the music rolls made by respondent's competitors.

(*b*) The agreements for exclusive dealings, as set forth in paragraph 8 hereof, have applied at various times to some 475 dealers in player rolls in the several states of the United States, and such dealers were and are in general the largest dealers in player rolls in the several states, and are distributors for a substantial part of respondent's business.

Par. 10. Such agreements for exclusive dealing, as set forth in paragraphs 8 and 9 hereof, under the conditions and in the circumstances therein set forth, have supplemented, and supplement, the policy of respondent in naming and maintaining its resale price for Q. R. S. music rolls, and in fact have been and are a factor aiding in such resale price maintenance.

Par. 11. The agreements for exclusive dealing, as set forth in paragraphs 8 and 9 hereof, under the conditions and in the circumstances therein set forth, have a capacity and tendency substantially to lessen competition, and do in fact substantially lessen competition in the sale and distribution of player rolls in the course of interstate commerce. The resale-price maintenance policy and practice of respondent as applied to Q. R. S. player rolls, as hereinabove set forth, taken in connection with the exclusive dealing agreements as aforesaid, have a dangerous tendency unduly to hinder competition and to create a monopoly in the manufacture and sale of music rolls for player pianos in the United States.

CONCLUSION

1. That the practices of the respondent as set forth in the foregoing findings as to the facts are. in the circumstances therein set forth, unfair

methods of competition in interstate commerce in violation of Section 5 of the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes."

2. That the practices of said respondent as hereinbefore set forth and recited, in the circumstances and under the conditions hereinbefore set forth, are in violation of Section 3 of the Act of Congress entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes."

ORDER TO CEASE AND DESIST

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission, the answer of the respondent, the testimony and evidence, the trial examiner's report upon the facts and the exceptions thereto, and upon briefs submitted by counsel and oral argument, and the Commission having made its findings as to the facts and reached its conclusion that the respondent has violated Section 5 of the Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes," and that respondent has violated Section 3 of the Act of Congress approved October 15, 1914, entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes,"

Now, therefore, it is ordered, That the respondent, The Q. R. S. Music Company, its officers, directors, agents, servants and employees cease and desist from carrying into effect a policy of fixing and maintaining uniform prices at which the articles manufactured by it shall be resold by its distributors and dealers by:

1. Entering into contracts, agreements and understandings with distributors or dealers requiring or providing for the maintenance of specified resale prices on products manufactured by respondent.

2. Attaching any condition, express or implied, to purchases made by distributors or dealers to the effect that such distributors or dealers shall maintain resale prices specified by respondent.

3. Requesting dealers to report competitors who do not observe the resale price suggested by respondent, or acting on reports so obtained by refusing or threatening to refuse sales to dealers so reported.

4. Requesting or employing salesmen or agents to assist in such policy by reporting dealers who do not observe the suggested resale price, or acting on reports so obtained by refusing or threatening to refuse sales to dealers so reported.

5. Requiring from dealers previously cut off promises or assurances of the maintenance of respondent's resale prices as a condition of reinstatement.

6. Utilizing any other equivalent cooperative means of accomplishing the maintenance of uniform resale prices fixed by the respondent.

It is further ordered, That respondent, The Q. R. S. Music Company, its officers, directors, agents, servants and employees cease and desist from entering into contracts, agreements or understandings or making sales or fixing a price charged therefor or discount from or rebate upon such price subject to the condition, agreement or understanding that the purchaser of respondent's product shall not deal in the goods, wares or merchandise of any competitor of respondent; and

It is further ordered, That the respondent, The Q. R. S. Music Company, shall file with the Commission, within sixty days after the service upon it of a copy of this order, its report in writing stating in detail the manner and form in which it has complied with the order to cease and desist hereinbefore set forth.[3]

COMMENTARY: The Q. R. S. rolls, according to the findings of the commission, "are considered in the trade as of high quality and the fact that they are nationally advertised creates a brisk demand for them. Dealers in music rolls for player pianos find their business success in this line promoted by ability to furnish their customers with Q. R. S. player rolls." These facts and the general nature of the demand for the product made it suited for selected retail distribution.[4] In order to promote the sale of Q. R. S. rolls, the company apparently selected as its customers retailers who operated stores which were well suited to the sale of such goods. It carried on a system of aiding the retailers in advertising and selling Q. R. S. rolls. To encourage each retailer to seek to attain a maximum volume of sales, quantity discounts based on the annual purchases of the retailers were granted. Privileges of making exchanges of unused rolls were allowed. And standard resale prices were suggested.

For Q. R. S. rolls, therefore, the company had a coordinated merchandising plan in which the standardization of resale prices was one element. Provided such a plan were well executed, with proper selection of the retailers, it is probable that all retailers would have tended to sell at the same prices even without the naming of resale prices by the manufacturer. In such a plan, therefore, the maintenance of resale prices was an incidental feature, not the major objective. The fact that the company had such a large volume of sales and that many consumers preferred to buy Q. R. S. rolls, even at prices above those of other makes of music rolls, indicates that consumers generally had accepted the standard prices as fair. The company seems to have attained its large volume of sales by establishing a reputation for its product as

[3] This order of the Federal Trade Commission was reviewed and affirmed by the United States Circuit Court of Appeals for the Seventh Circuit, 12 Fed. (2d) 730.

[4] Copeland, Melvin T., *Principles of Merchandising,* pp. 103-106, 117-121. See also "Some Legal Aspects of Merchandising," *Harvard Business Review,* Vol. IV, No. 3, April, 1926, pp. 362-373.

being of high quality, by its competitive advertising, and by selecting as its agents retailers who were qualified to promote sales aggressively.

When the company entered into agreements with some of the retailers whereby in return for liberal exchange privileges those retailers agreed not to sell competing makes of music rolls, the company was entering on uncertain ground. It is not difficult, however, to comprehend that the company could not safely have extended the exchange privilege without safeguarding its interests by making sure that retailers would not take unfair advantage of the privilege. On the merchandising aspects of this policy, however, the commission's findings shed little light. Inasmuch as such exclusive agreements had been made with less than 7% of the company's customers—475 retailers from among 7,500—this arrangement appears to have been a secondary feature of the company's general merchandising program. Under the circumstances it was of doubtful propriety.

The commission stated in its findings: "At the demand of customers who were competitors of other customers in the sale of Q. R. S. player rolls, respondent has cut off or refused to sell such other customers, because such other customers had failed or refused to observe and maintain the resale price of Q. R. S. player rolls named by respondent in its catalogs, and such action was taken as a condition upon which such demanding customers continued to observe and maintain the resale prices named by respondent on Q. R. S. player rolls." It was stated, further, that the company had refused to sell to retailers who would not promise to maintain resale prices on Q. R. S. player rolls. In the light of the Beech-Nut decision,[5] those facts constituted technical grounds for an adverse decision by the commission, irrespective of the broad merits of the company's general merchandising plan and the relation of the standardization of resale prices to the other features of that plan.

June, 1926 M. T. C.

[5] Federal Trade Commission *v.* Beech-Nut Packing Company, page 479.

Federal Trade Commission *v.* Houbigant, Incorporated[1]

MANUFACTURER—PERFUMERY AND TOILET ARTICLES

Price Maintenance—*Standardization of Resale Prices by Cooperative Means Held Illegal.* The Federal Trade Commission, in a proceeding which it brought against the company, a manufacturer of perfumery and toilet articles, found that retailers to which the company sold, at the instigation of the company, reported the names of price-cutters; that the company thereupon undertook to obtain assurances from the price-cutters that they would maintain its specified resale prices; and that the company subsequently reported the results of such efforts to its informers. The commission ordered the company to discontinue these practices.[2]

(1926)

FINDINGS AS TO THE FACTS

Paragraph 1. Respondent is now and since 1920 has been a corporation, organized under the laws of the state of New York, with its principal place of business at the city of New York, in said state. During its corporate existence, respondent has been and is now engaged in the sale of perfumery and toilet articles, and the distribution thereof in interstate commerce from its principal place of business, to dealers throughout the United States. Since August, 1922, it has sold and distributed its merchandise exclusively to retail drug stores and department stores. Orders for its merchandise are solicited by means of traveling salesmen, some 25 in number at the present time, and also by means of catalogs. Respondent transports or causes to be transported, its merchandise when sold, from its principal place of business in the state of New York, to its customers located in the various states of the United States, and has at the present time about 6,000 customers, some in every state of the United States. Its annual sales amount to several million dollars, and it is one of the largest perfumery dealers in the United States.

Par. 2. In the course and conduct of its said business, respondent is and has been during its corporate existence in competition with other corporations, partnerships and individuals also engaged in the business of selling perfumery at wholesale and transporting same in interstate commerce from their respective locations in the United States, throughout the various states of the United States.

Par. 3. Respondent since August 15, 1922, has sold its merchandise

[1] Federal Trade Commission, Docket 1250, April 2, 1926.

[2] Headnote of Graduate School of Business Administration.

in accordance with a policy adopted by it, of fixing and maintaining the prices at which its various articles of merchandise should be resold to the consuming public by the retail merchants handling such articles. In carrying out said policy respondent has sought and secured the assistance and cooperation of its retail dealers, and of its officers, agents and employees. Respondent's efforts in behalf of price maintenance have during said period of time received the approval and adoption by its leading dealers in all the cities of the country.

Par. 4. In pursuance of its price maintenance policy, respondent on September 15, 1922, issued a catalog in which were described the several hundred articles sold by it, together with a sum set opposite to each of said articles, which sum was designated as the "retail price" of such article. Said catalog also contained the terms or conditions upon which said articles were offered for sale. Among these terms or conditions as designated, was the phrase "Established Selling Prices", which had reference to the designated retail prices appearing in the catalog as heretofore in this paragraph mentioned, and respondent, in the course and conduct of its business, has sold and does sell much of its merchandise upon orders made by the vendees, based solely upon the catalog. Respondent has continued since August 15, 1922, to issue to the trade similar catalogs, all of them containing the retail prices and term or condition of sale above mentioned. Respondent's catalogs are widely distributed to its customers and prospective customers.

Par. 5. In furtherance of said price maintenance policy, the respondent has secured generally, promises and agreements from its customers for the resale of its articles of merchandise at the established prices, and respondent generally sells its merchandise upon promises obtained from or agreements and understandings arrived at, with its customers, for the resale of its merchandise at the established prices.

Respondent sometimes on its own initiative, but more often upon the complaint of a dealer of price-cutting on the part of other dealers in a given locality, has through its agents and with the assistance of dealers favorable to the observance of the established prices, secured from all its dealers in the given locality a general agreement between and among said dealers and the respondent for the maintenance in the future of the established resale prices.

Par. 6. Dealers are requested by respondent to report the names of price-cutters, meaning those selling respondent's products at a price below that fixed by respondent, and to make investigations for the purpose of identifying price-cutters and ascertaining the details of the price-cutting and such dealers are given to understand that the purpose of securing such information by the respondent is to eliminate price-cutting, either by refusing further sales of its merchandise to a price-cutter or securing from him his assurance that the established prices will be observed by him in the future. Respondent has in many instances, as a result of investigations instituted upon reports received from its dealers, refused further sales to persons found to have been

cutting prices, and in many other instances has by correspondence or by its salesmen through personal interviews, secured from the price-cutters assurance for the observance of the established prices in the future. In such cases it is the practice of the respondent to report back to the informant dealers the result of the investigation.

The respondent also requests and procures from its salesmen and other agents, reports and information as to price-cutting by its dealers and acts upon the information thus obtained by refusing sales to the price-cutter or securing his assurance that he will observe the established prices in the future.

Par. 7. The effect of the enforcement of respondent's price maintenance policy by the methods herein before mentioned is that retail dealers handling respondent's articles of merchandise, generally throughout the United States, have sold and do sell such articles to the consuming public at the uniform established prices fixed by respondent, thereby preventing such dealers from selling respondent's articles of merchandise at such lower prices as might be deemed by them to be warranted by their respective costs of operation and thus suppressing and hindering competition in respect to respondent's merchandise in interstate commerce.

CONCLUSION

The practices of the said respondent, under the conditions and circumstances set forth herein, are unfair methods of competition in commerce, and constitute a violation of Section 5 of an Act of Congress, approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes."

. . . .

It is now ordered that the respondent, Houbigant, Incorporated, its officers, agents, representatives, servants and employees do cease and desist from directly or indirectly carrying into effect a system of uniform resale prices in which respondent, its customers and agents undertake to prevent others from obtaining the company's products at less than the prices designated by it.

1. By entering into contracts, agreements or understandings with dealers, or any of them, that respondent's products are to be resold by such dealers at prices specified or fixed by respondent;

2. By procuring either directly or indirectly from its dealers promises or assurances that the resale prices fixed by respondent will be observed by such dealers;

3. By requesting dealers to investigate and report to respondent the names of other dealers who do not maintain respondent's designated resale prices;

4. By acting upon reports or communications from dealers concerning price-cutting on respondent's products by other dealers, by securing

assurances that respondent's designated resale prices will be observed.

It is further ordered that the respondent, Houbigant, Incorporated, shall within sixty days after the service upon it of a copy of this order, file with the commission a report in writing setting forth in detail the manner and form in which it has complied with the order to cease and desist hereinbefore set forth.

COMMENTARY: The facts in this case are similar to those in the Hills Brothers case[3] and the same comment in general applies. This case affords one more example of the extent to which the Federal Trade Commission has been active in repressing manufacturers' efforts to maintain resale prices.

One statement in the commission's "Findings as to the Facts" in this case deserves special consideration. In the final paragraph of its finding as to the facts the commission stated:

> The effect of the enforcement of respondent's price maintenance policy by the methods hereinbefore mentioned, is that retail dealers handling respondent's articles of merchandise, generally throughout the United States, have sold and do sell such articles to the consuming public at the uniform established prices fixed by respondent, thereby preventing such dealers from selling respondent's articles of merchandise at such lower prices as might be deemed by them to be warranted by their respective costs of operation and thus suppressing and hindering competition in respect to respondent's merchandise in interstate commerce.

That statement might be interpreted as implying that the dealers who had attempted to cut prices on this merchandise had sought merely to adjust the mark-ups on the merchandise to conform to their operating expenses. No facts are cited to prove that point. Inasmuch as advertised brands of merchandise often are used as price leaders, the implications in the commission's statement just noted are open to challenge; a dealer may cut prices on an advertised brand in order to trade on the manufacturer's reputation even when that dealer is not operating his store more economically than competitors operate their stores. That is a type of unfair trading to which the commission might well direct its attention.

June, 1926 M. T. C.

[3] Federal Trade Commission *v.* Hills Brothers, page 559.

INDEX

INDEX

E